JOHN T. FEY, Clerk

No. 855

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

SHIRLEY-DUKE APARTMENTS, SECTION 1, INCORPORATED, *et al.*,
PETITIONERS,

v.

NORMAN P. MASON, FEDERAL HOUSING COMMISSIONER, *et als.*,
RESPONDENTS.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

ARMISTEAD L. BOOTHE,
BOOTHE, DUDLEY, KOONTZ & BOOTHE,
505 King Street,
Alexandria, Virginia.

CARL BUDWESKY,
4613 Duke Street,
Alexandria, Virginia.
Counsel for Petitioners.

NEWELL-COLE CO., INC., ALEXANDRIA, VA.

INDEX

	PAGE
OPINIONS BELOW	2
JURISDICTION	2
QUESTIONS PRESENTED	2-5
STATUTES AND REGULATIONS INVOLVED	5-7
STATEMENT OF THE CASE	7
A. History of the National Housing Act With Special Reference to Section 608, and Related Sections 207, 803 and 908	7-22
B. History of the Shirley-Duke Corporations	22
(1) Applications	22
(2) Commitments	23-25
(3) Incorporation	25
(4) Construction	25, 26
(5) Trusts	27
(6) Appraisal and Distribution	28
(7) Miscellaneous	29, 30

ARGUMENT

SUMMARY:

The Distribution to Shirley-Duke Stockholders of December 11, 1950, Was a Proper Distribution of Net Assets in Excess of Capital, Legally Acquired and Legally Possessed. The Distribution Was Authorized by the Law of Virginia, Was Permitted by Charter, Was Sanctioned by By-Laws, Was Approved by FHA Rules and Practices, Was Ratified by the FHA and Was Consonant With Knowledge and Acts of Congress	31
I. The Distribution to the Shirley-Duke Stockholders Was Made from Net Assets in Excess of Capital, Resulting from Valid Appreciation in Value of Corporate Properties. Such Distribution Was Permitted, and Not Prohibited	32
I(a) Article V(a) of the Shirley-Duke Charters Did Not Prohibit the Distribution. Article V(a) Did Not Even Refer to or Concern the Assets Distributed	32-39

PAGE

I(b) Article IV(b) of the Shirley-Duke Charters Permitted the Distribution of Net Earnings. Article IV(b) Did Not Prohibit or Limit the Distribution of Net Assets in Excess of Capital 39-46

I(c) The Distribution to Shirley-Duke Stockholders of Net Assets In Excess of Capital Resulting From Unrealized But Valid Appreciation in Value of Corporate Properties is Authorized by Statute Law and Decisions 46-58

II. Both Courts Below Invested Congress With a Positive Intent or Plan to Prohibit Distribution of Excess Mortgage Proceeds Under Section 608. The Clear Indication from the Record is Contrary to These Holdings. The Deliberations and Acts of Congress Show Positively an Undeviating Purpose of Congress to Obtain Vitally Needed Housing by Offering Enticing Financial Inducements to Mortgagors, and an Awareness of Congress That Efficient Builders Would Build for Lower Costs Than the FHA Estimated Costs for Typical Builders, and That the Resulting Profits Would Be Subject to Distribution. When Congress Intended or Planned to Prohibit Distributions, It Did So in Explicit Language, Such as That Contained in Sections 207, 803 and 908 of the National Housing Act 58-66

III. The Rule of Law Requiring That an Ambiguous Provision of a Contract Be Construed Against the Draftsman Should Not Be Reversed Because the Draftsman is a Federal Agency 66-72

IV. *The Axiom Inclusio Unius Est Exclusio Alterius* is Applicable Although a Federal Agency is Involved 72-75

V. The Shirley-Duke Corporations Are Subject to the Corporations Laws of Virginia. The Holdings of Preferred Stock by the FHA Does Not Make the Corporations Instrumen-

PAGE

talities of the Federal Government or Place Them Above the Law 75-83

VI. The FHA, Engaged as It Is in the Proprietary Function of Insuring Loans, Is Subject to the Laws of Estoppel and Contemporaneous Interpretation 83-87

CONCLUSION 88

TABLE OF CITATIONS

CASES:

Augusta Trust Company v. *Augusta H. & G. R. Co.* (Me. 1936), 187 A. 1 42

Bailey v. *Holland* (C. A. 4th Cir. 1942), 126 F. 2d 317 84

Bank of the United States v. *Planters' Bank of Georgia* (1824), 9 Wheat. 904, 6 L. ed. 244 ..... 77, 78, 79

Berks Broadcasting Co. v. *Craumer,* (Pa. 1947), 52 A. 2d 571 57

Branson v. *Wirth* (17 Wall.), (U. S.) 32, 21 L. ed. 566 83

Byram Holding Co. v. *Bogren* (N. J. 1949), 63 A. 2d 822 80

Cannon v. *Wiscassett Mills Co.* (N. C. 1928, 141 SE 344) 50, 56

Choy v. *Farragut Gardens* (D. C. S. D. N. Y. 1955), 131 F. Sup. 609 65

Commissioner of Int. Rev. v. *Gross,* (C. A. 2nd Cir. 1956), 236 F. 2d 612 ..... 49, 50, 51, 66

Commissioner of Int. Rev. v. *Hirshon Trust* (C. A. 2nd Cir. 1954), 213 F. 2d 523, cert. den. Oct. 25, 1954, 99 L. ed. 46 ..... 49, 51, 52

Dalton v. *LeLande* (Cal. 1913), 135 P. 54; 65 L. ed. 108 note 63

Dinkes v. *Glen Oaks Village* (N. Y. 1954), 132 N. Y. S. 2d 138 ..... 31, 65

PAGE

E. I. DuPont de Nemours & Co. v. *Claiborne Reno Co.* (C. A. 8th Cir. 1933), 64 F. 2d 224 68

Edwards v. *Douglas* (1925), 269 U. S. 204, 214, 70 L. ed, 235, 240 ..... 54, 55

Ellingwood v. *Wolf's Head Oil Ref. Co.* (Del. 1944), 38 A. 2d 743, 154 A. L. R. 406 42

Falcon, The (D. C. Md. 1927), 19 F. 2d 1009 83

Federal Housing Administration v. *Burr* (1940), 309 U. S. 242, 84 L. ed. 724 80

Federal Housing Administrator v. *Moore* (C. A. 9th Cir. 1937), 90 F. 2d 32 42

Federal Land Bank v. *Priddy* (1935), 295 U. S. 229, 79 L. ed. 1408 81

Ferguson v. *Union National Bank of Clarksburg, W. Va.* (C. A. 4th Cir. 1942), 126 F. 2d 753 ..... 86, 87

Fletcher v. *Peck* (1810), 6 Cranch (U. S.) 87, 3 L. ed. 162 ..... 81, 83

Grace v. *American Century Ins. Co.* (1883), 109 U. S. 278, 27 L. ed. 932 68

Graham v. *Louisville Transit Co.* (Ky. 1951), 243 SW 2d 1019 ..... 50, 57

Great Northern Railway Co. v. *United States* (1942), 315 U. S. 262, 86 L. ed. 836 ..... 63, 64, 84

Green v. *Royal Neighbors* (Kan. 1937), 73 P. 2d 1 68

Hamilton Mfg. Co. v. *United States* (C. A. 7th Cir. 1954), 214 F. 2d 644 40

Hayman v. *Morris* (Sup. Ct. N. Y. 1942), 36 N. Y. S. 2d 756 ..... 50, 55

Heald v. *District of Columbia* (1920), 254 U. S. 20, 65 L. ed. 106 63

Hoffmann v. *Pfingsten* (Wis. 1951), 50 NW 2d 369 68

PAGE

Indian Towing Company v. *United States* (1955), 350 U. S. 64, 100 L. ed. 83 81

James River And Kanawha Co. v. *Early* (1856), 13 Gratt. (54 Va.) 541 79

Keifer & Keifer v. *Reconstruction Finance Corporation* (1939), 306 U. S. 381, 83 L. ed. 784 ..... 78, 79, 81, 84

Kingston v. *Home Life Ins. Co.* (Dela. 1917), 101 A. 898 58

Knights of Pythias v. *Weller* (1896), 93 Va. 605 43

LaBelle Iron Works v. *United States* (1921), 256 U. S. 377, 65 L. ed. 998 57

Levin v. *Stratford Plaza* (Md. 1950), 76 A. 2d 558, 561 ..... 30, 65

Lyman-Richey Sand & Gravel Co. v. *State* (Neb. 1932), 243 NW 891 68

Miller, In Re: (C. A. 2d Cir. 1939), 105 F. 2d 926 42

Miller v. *Walters* (N. Y. 1942), 34 N. Y. S. 2d 341 65

Missouri ex. rel. Barrett v. *First National Bank of St. Louis* (Mo. 1923), 249 S. W. 619, 30 A. L. R. 918, affirmed 263 U. S. 640, 68 L. ed. 486 ..... 81, 82

Mobile & Ohio R. Co. v. *Tennessee* (1894), 153 U. S. 486, 38 L. ed. 793 45

Morris v. *Standard Gas & Elec. Co.* (Ch. Del. 1949), 63 A. 2d 577 ..... 50, 55, 66

National City Bank v. *Republic of China* (1955), 348 U. S. 356, 99 L. ed. 389 78

National Labor Relations Board v. *Gullett Gin Co.* (1950), 340 U. S. 361, 95 L. ed. 337 63

Newfield v. *Oosterhuis* (C. A. 2nd Cir. 1943), 137 F. 2d 437 ..... 49, 52

Partmar Corporation, et al. v. *Paramount Picture Theaters Corporation, et al.* (1954), 349 U. S. 89, 98 L. ed. 532, 74 S. Ct. 414 68

PAGE

Pinnacle Packing Co. v. *Herbert* (Ore. 1937), 70 P. 2d 31 68

Randall v. *Bailey* (Sup. Ct. N. Y. 1940), 23 N. Y. S. 2d 173, affirmed unanimously Sup. Ct. Ap. Div. 1941 29 N. Y. S. 2d and reaffirmed unanimously Court of App. N. Y. 1942 43 NE 2d 43 ..... 50, 52, 53, 54, 55, 57

Reconstruction Finance Corporation v. *Sun Lumber Co.* (C. A. 4th Cir. 1942), 126 F. 2d 731 83

Riordan v. *Ferguson* (C. A. 2nd Cir. 1945), 147 F. 2d 983, affirming (D. C. N. Y. 1941), 42 F. Supp. 47 80

Seaboard Finance Corp. v. *Commonwealth* (1946), 185 Va. 280 84

Seven Oaks v. *Federal Housing Administration* (C. A. 4th Cir. 1948), 171 F. 2d 947 79

Sheridanville, Inc. v. *Borough of Wrightstown* (D. C. N. J. 1954), 125 F. Supp. 743 80

Shwab v. *Doyle* (1922), 258 U. S. 529, 66 L. ed. 747 65

Slaymaker's Adm'r. v. *Jaffray & Co.* (1886), 82 Va. 346 ..... 41, 46

Sloan Shipyards Corp. v. *United States Shipping Board Emergency Fleet Corp.* (1922), 258 U. S. 549, 66 L. ed. 762 79

Spring City Foundry Co. v. *Commissioner of Int. Rev.* (1934), 292 U. S. 182, 78 L. ed. 1200 64

Tennant v. *Epstein* (Ill. 1934), 189 N. E. 864, 98 A. L. R. 1515 42

United States v. *Copper Corporation* (1941), 312 U. S. 600, 85 L. ed. 1071 ..... 73, 75

United States v. *Federal Power Commission* (C. A. 4th Cir. 1951), 191 F. 2d 796, affirmed 345 U. S. 153, 97 L. ed. 918 64

PAGE

United States v. *Hansett* (C. A. 2d Cir. 1941), 120 F. 2d 121 80

United States v. *McClure* (1939), 305 U. S. 472, 83 L. ed. 296 64

United States v. *Riely* (C. A. 4th Cir. 1948), 169 F. 2d 542 ..... 41, 42, 43, 45, 46

United States Shipping Board Merchant Fleet Corporation v. *Harwood* (1930), 281 U. S. 519, 74 L. ed. 1011 81

United States v. *Wood*, (C. A. 4th Cir. 1938) 99 F. 2d 80 83

United States v. *Wrightwood Dairy Company* (1942), 315 U. S. 110, 86 L. ed. 726 ..... 63, 64

VEPCO v. *Carolina Peanut Co.* (C. A. 4th Cir. 1951), 186 F. 2d 816, 32 A. L. R. 134 42

Warren v. *King* (1883), 108 U. S. 389, 27 L. ed. 769 42

Warren v. *United States* (DC Mass. 1948), 76 F. Supp. 587 ..... 49, 52

Weaver v. *Commissioner*, (1956), 25 T. C. No. 121 66

Webb City Undertaking Co. v. *Sinclair*, (Mo. 1949), 225 SW 2d 138 ..... 50, 56

Weinberg v. *Baltimore Brick Co.*, (Sup. Ct. Del. 1955), 114 A. 2d 812 44

Wilson v. *Commissioner*, (1956), 25 T. C. No. 120 66

STATUTES AND RULES

National Housing Act:

PAGE

§ 207(b)(2), as in effect on and after June 27, 1934, 12 U. S. C. § 1713(b)(2) (Ap. 6) 5

§ 608, as passed May 26, 1942, 12 U. S. C. § 1743 (Ap. 4, 5) 5

§ 608, as amended May 22, 1946, 12 U. S. C. § 1743 (Ap. 5) 6

§ 608, as amended August 10, 1948, 12 U. S. C. § 1743 (Ap. 3, 4) 6

§ 803(b), as amended June 30, 1953, 12 U. S. C. § 1748b(b) (Ap. 6, 7) 6

§ 908(b)(2)(B), as passed September 1, 1951, 12 U. S. C. 1750g(b)(2)(B) 6

§ 908(b)(3) as passed September 1, 1951, 12 U. S. C. 1715r and 1750g(b)(3) (Ap. 7) 6

26 U. S. C. (I. R. C. 1939), § 115(c) 6

26 U. S. C. (I. R. C. 1939), § 115(d) 6

26 U. S. C. (I. R. C. 1939), § 117(m), "Collapsible Corporation Act" 6, 66

Virginia Code of 1950, § 13-3 ..... 6, 43

Virginia Code of 1950, § 13-206 ..... 6, 7, 40, 41, 43, 47, 74

Virginia Code of 1950, § 513.1-43 ..... 7, 40, 41, 47

"Administrative Rules and Regulations for Rental Housing Insurance Under Section 608 of the National Housing Act", revised December 19, 1947, as amended April 20, 1950, excerpts (Ap. 88, 95), (24 C. F. R. 280.1-280.46) 7

Other Authorities:

Fletcher's Cyclopedia on Corporations, Permanent Edition 1933, § 9032 75

Permanent Edition 1933, § 9033 58

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. ———

SHIRLEY-DUKE APARTMENTS, SECTION 1, INCORPORATED, SHIRLEY-DUKE APARTMENTS, SECTION VI, INCORPORATED, BRYAN GORDON, JR., CALVIN O. BLACK, SHIRLEY-DUKE APARTMENTS, SECTION II, INCORPORATED, SHIRLEY-DUKE APARTMENTS, SECTION III, INCORPORATED, E. J. PRESTON, E. M. BROS, SHIRLEY-DUKE APARTMENTS, SECTION IV, INCORPORATED, SHIRLEY-DUKE APARTMENTS, SECTION V, INCORPORATED, RUSSELL T. MORRIS, individually, and as Ancillary Adminstrator of the Estate of HERMAN W. HUTMAN, deceased, PETITIONERS,

v.

NORMAN P. MASON, FEDERAL HOUSING COMMISSIONER, and FEDERAL HOUSING ADMINISTRATION, RESPONDENTS.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered on January 7, 1957, in the above-styled case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit has not yet been reported, but is appended hereto (pp. 1A-10A). The opinion of the United States District Court for the Eastern District of Virginia is reported at 139 F. Supp. 207-213, and is contained in "Consolidated Appendix for Appellants" printed for the use of the Court below, nine copies of which are filed in this Court with this Petition (App. 164-174)*.

JURISDICTION

The date of the judgment sought to be reviewed and the time of its entry is January 7, 1957. The statutory provisions believed to confer on this Court jurisdiction to review the judgment in question by Writ of Certiorari are 28 U. S. C. 1254, 28 U. S. C. 2101, 12 U. S. C. 1702, and 12 U. S. C. 1743.

QUESTIONS PRESENTED

The comprehensive question in this case, reduced to its simplest form is:

> Under Section 608 of the National Housing Act and the Rules of the Federal Housing Administration, Were the Petitioner Corporations Prohibited From Distributing To Their Stockholders Net Assets in Excess of Capital Which Had Been Legally Acquired and Were Legally Possessed?

On this question the Court of Appeals has decided an important issue of Federal law which has not been, but should be settled, by this Court:**

---

* In this Petition, the abbreviation "Ap." refers to "Consolidated Appendix for Appellants" printed for the use of the United States Court of Appeals for the Fourth Circuit; while the abbreviation "R. Ap." refers to "Consolidated Appendix For The Respondents" printed for the use of the same Court.

** As to importance of issue, see Arguments, *infra*, 88.

The ultimate question expressed above involves six subsidiary questions:

I. Were the Petitioner Corporations Prohibited from Distributing to Their Stockholders Net Assets in Excess of Capital, which Net Assets Resulted from Valid Appreciation in Value of Corporate Properties?

II. Should a Court Extract an Intent of Congress from the Court's Own Opinion as to What the Law Ought To Have Been Despite the Record as to What the Law Was and as to What the Knowledge of Congress Was When It Enacted and Re-enacted the Law?

III. Should the Rule of Law Requiring That a Contract Be Contsrued Strictly Against the Draftsman Be Reversed Where the Draftsman Is a Federal Agency?

IV. Should the Axiom *Inclusio Unius Est Exclusio Alterius* Be Reversed Where a Federal Agency Is Involved?

V. Does the Holding of Preferred Stock in a Business Corporation by a Federal Agency Make the Cor-Corporation an Instrumentality of the Federal Government and Place It Above the Law of the State of Its Creation?

VI. Is an Agency of the Federal Government No Longer Subject to the Doctrine of Contemporaneous Interpretation?

On all six of these subsidiary questions the Court of Appeals has rendered a decision in conflict with decisions of other Courts of Appeal on the same matters, or has decided Federal questions in a way in conflict with applicable decisions of this Court.*

---

* As to conflict in decisions, see Argument, *infra*, 48, 49, 66, 74, 82, 86.

As preposterous as it may appear, the Respondents must obtain affirmative answers to all seven of the above questions in order to prevail. Therefore, they argue that the end justifies the means, that the Petitioners made too much money too fast and that the distribution of the money should be disallowed in spite of the law and the facts involved.

From the beginning this case was presented to the Lower Courts as though the basic question was whether the Petitioner stockholders made large sums of money more quickly than the Courts thought they should have been allowed to make them. The effectiveness of this presentation was instigated and accentuated by publicity and hindsight, in newspapers and in Congress.* Actual facts, including debates of Congress, and rules, interpretations and practices of the FHA, which stick out like sore thumbs in the history of the National Housing Act, have had to be dis-

---

* For instance, see comment in Respondents' Brief filed in the Court of Appeals (p. 13 footnote):

> "The dividend rates on the common stock for which $5.00 per share had been paid were $2,472.10, $1,758.67, $1,563.52, $2,193.46, $1,855.90 and $1,346.80, respectively, for each of the six Shirley-Duke Corporations (R. Ap. 61a)."

And note the following language from the opinion of the Court of Appeals:

> "The common stockholders of the plaintiffs had made no more than a token investment in their stock. . . ." (*infra*, 1A);

and

> ". . . common stockholders whose investment was insignificant in comparison with the amount thus paid to them out of the proceeds of the loans." (*infra*, 2A);

and

> "Upon stock in which one stockholder in Shirley-Duke Apartment had invested $90.00, he received exceeding $62,000.00 in this 'dividend' ". (*infra*, 2A footnote).

Actually the distribution to which Judge Parker refers was made to the lawyer of the corporation in consideration of constant, burdensome and necessary legal services rendered by him over a period of two years.

regarded. The record necessarily has been ignored. The Respondents' basic argument in effect is that if the law or the regulations, or the practices or the charters *did not prohibit* the distribution of earnings in this case, then they *should have prohibited* them, and now should be rewritten *ex post facto* by the Courts *in order to prohibit* such distribution.

However, the law, the rules, the practices and the charters are so clear that Petitioners succeeded, over Respondents' opposition, in establishing in both Lower Courts that *the savings were legally earned, legally possessed*, and *even might have been legally "lavished"* on the projects during construction (Ap. 171). Before this Court the Petitioners seek to show that the savings were also *legally distributed*.

Such distribution was permitted by the law of Virginia (*infra*, 10A, 11A) and by the by-laws of the corporations (Ap. 125, 126). Moreover, the distribution of these savings was invited by the practices of the FHA, under the rules and regulations of the FHA. These practices and rules in turn were precipitated by the ultra liberal, financially enticing provisions of Section 608 of the National Housing Act, passed May 22, 1946, by Congress. Congress was launched and continued upon this legislative course, with its eyes wide open, due to a national housing emergency, overwhelming at times and critical through the years 1946 to 1950.

STATUTES AND REGULATIONS INVOLVED

§ 207(b)(2), National Housing Act, as in effect on and after June 27, 1934, 12 U. S. C.

§ 1713(b)(2) (Ap. 6).

§ 608, National Housing Act, as passed May 26, 1942, 12 U. S. C. § 1743 (Ap. 4, 5).

§ 608, National Housing Act, as amended May 22, 1946, 12 U. S. C. § 1743 (Ap. 5).

§ 608, National Housing Act, as amended August 10, 1948, 12 U. S. C. § 1743 (Ap. 3, 4).

§ 803(b), National Housing Act, as amended June 30, 1953, 12 U. S. C. § 1748(b) (Ap. 6, 7).

§ 908(b)(2)(B) as passed September 1, 1951, 12 U. S. C. 1750g(b)(2)(B), which reads as follows:

> § 908(b)(2). "The mortgage shall involve a principal obligation in an amount . . . Not to exceed $5,000,-000.00; and Not to exceed 90 per centum of the amount which the Commissioner estimates will be the value of the property or project when the proposed improvements are completed".

§ 908(b)(3) as passed September 1, 1951, 12 U. S. C. 1715r and 1750g(b)(3) (Ap. 7).

26 U. S. C. (I. R. C. 1939), § 115(c).

26 U. S. C. (I. R. C. 1939) § 115(d).

26 U. S. C. (I. R. C. 1939), § 117(m), "Collapsible Corporation Act".

Virginia Code of 1950, § 13-3, which reads as follows:

> "The general statutes of this State applicable to corporations shall be a part of the charter of every corporation formed under the laws of this State, except so far as the same are inapplicable or inappropriate to the objects of such corporation."

Virginia Code of 1950, § 13-206, which provides:

"The board of directors of every corporation shall, unless otherwise provided in its charter . . . have power to declare and pay dividends upon the shares of its capital stock out of its net earnings, or out of its net assets in excess of its capital . . ." *

Virginia Code of 1950, § 13.1-43, which provides:

"(a) Dividends in cash or property may be declared and paid . . . only out of unreserved and unrestricted earned surplus of the corporation or out of capital surplus, howsoever arising." **

"Administrative Rules and Regulations for Rental Housing Insurance Under Section 608 of the National Housing Act", revised December 19, 1947, as amended April 20, 1950, excerpts (Ap. 88, 95). (24 C. F. R. 280.1-280.41; 24 C. F. R. 532.1-532.24) (infra, 37A).

STATEMENT OF THE CASE

A.

History of the National Housing Act With Special Reference to Section 608, and Related Sections 207, 803 and 908

Section 608 of the National Housing Act, as in effect for the Shirley-Duke corporations, authorized the Commissioner of the Federal Housing Administration to insure mortgages on rental housing projects in a sum:

(1) Not to exceed 90% of the amount which *the Commissioner estimates* will be the necessary current cost of the completed property or project, including the structures, the land, on-site utilities, taxes, interest, miscellaneous construction charges, and architects' and builders' fees (Ex. 1, Ap. 4, Ex. 24, Ap. 40, Ex. 31, Ap. 82, Ex. 32, Ap. 83);

---

* § 13-206 of the Virginia Code of 1950 is set out in full, *infra*, 10A, 11A.

** § 13.1-43 of the Virginia Code of 1950 is set out in full in so far as it is pertinent, *infra*, 11A, 12A.

and

(2) Not to exceed the amount which *the Commissioner estimates* will be the cost of the completed physical improvements, inclusive of on-site utilities, architects' and builders' fees and overhead, but exclusive of off-site public utilities and streets, and organization and legal expenses (Ex. 1, Ap. 4, Ex. 24, Ap. 45, 63, 64, Ex. 69-A, p. 3, Ap. 152); and

(3) Not to exceed 90% of *the Commissioner's estimate* of the replacement cost of the property or project on the basis of costs prevailing on December 31, 1947, for properties or projects of comparable quality (Ex. 1, Ap. 4); and

(4) Not to exceed $8100 per family unit(Ex. 1, Ap. 4, Ex. 24, Ap. 44).

The Shirley-Duke mortgages fulfilled each and every one of these requirements of the law.

1934: To meet the Nation's need for housing, the National Housing Act, including Titles I through V, was passed June 27, 1934. Section 207 of that Act was and is still the permanent, more conservative section dealing with rental housing insurance. FHA mortgage insurance operations under 207 were based on criteria of "appraised value and economic soundness" (Ex. 5, p. 175).

1941: Title VI, through Section 607, was enacted March 26, 1941.

1942: A much more liberal rental housing law became necessary after the outbreak of World War II. Added incentives were needed beyond the provisions of 207 to encourage sponsors, builders and lenders (Ex. 2, Ap. 12). Accordingly, Section 608 was enacted May 26, 1942.

A most significant difference existed between the provisions of 207 and 608 from the initial passage of 608. *Section 207 required the Federal Housing Administrator to regulate and restrict* mortgagor corporations as to rents, charges, capital structure, *rate of return*, and method of operation. *Section 608 made it discretionary with the Commissioner to so regulate and restrict* (Ex. 1, pp. 38, 74, 123, Ap. 3, 6). The potency of this difference is shown by the fact that *the Commissioner did regulate and restrict the rate of return under 207 but did not regulate or restrict the rate of return under 608* (Ex. 13, 39, Ap. 21, 22, 90).

The possibility of substantial profits under 608 was foreseen even before its passage in 1942. A witness before a Congressional Committee predicted that a speculator could undertake a large scale project under 608, without any capital of his own, borrow out some profit, and milk out further profit (Ex. 6, Ap. 15). But the need for construction of war rental housing was critical, and 608 was designed, and enacted in spite of its dangers, to provide the necessary incentive to sponsors, builders and lenders (Exs. 2, 3, Ap. 12, 13).

1946: After the War, the critical housing shortage became a national emergency. Three million married veterans needed housing. Over a million families were "doubled up". There was a need for 3,000,000 moderately low priced homes and apartments within two years (Ex. 7, Ap. 16) and a "great demand" for rental housing (Ex. 8, Ap. 18).

Section 207, part of the permanent FHA law, could not do the job. Accordingly, since "the emergency begets the need", Section 608 was reactivated May 22, 1946, as an "emergency measure" originally for a term of approximately a year, offering "special incentives" to attract

capital and to stimulate production of rental housing (Exs. 8, 11, Ap. 17-20). A Housing Expediter was created to direct the drive for housing (Ex. 13, Foreword). Section 608 was too liberal to be of "permanent duration" but was hailed as the most beneficial act to the American people passed by the 79th Congress, and as throwing "the veterans' housing program into high gear" (Exs. 7, 37, Ap. 20, 87, 88).

Another most significant and pertinent liberalization was made in 608 at this time. The legal permissible limitation on a mortgage not to exceed 90 per centum of *the Commissioner's estimate of "reasonable replacement cost"* was changed to 90 per centum of *the Commissioner's estimate of "necessary current cost"* (Ex. 1, Ap. 4, 5). This amendment was adopted to protect the mortgagor and builder against falling as well as rising prices, and to *permit firm insurance commitments by the FHA to mortgagees ahead of construction regardless of actual costs* (Ex. 5, p. 176, Exs. 33, Ap. 86).

Armed with the liberal law of 1946, the FHA began a real bombardment of sponsors, mortgagors and lenders in order to obtain construction of rental housing. It held country-wide meetings of builders (Ex. 4, Tr. 69, R. 227). It instructed the directors of its field offices:

"Don't make it tough, make it easy", and

"If you have the site, you have a deal" (Ex. 12, p. 3683).

In September of 1946, the Expediter of the National Housing Agency and the FHA jointly issued an elaborate pamphlet entitled "Rental Housing for Veterans". This brochure was aimed to "stimulate interest in construction" and offered "exceptionally attractive terms", "the most generous terms in the history of the FHA". Accelerated

depreciation for income tax purposes was held out as an inducement. *The mortgage might represent up to 90% of the Commissioner's estimate of "'necessary current cost' of the completed project, including land, and 100% of his estimate of the cost of the improvements,* rather than of 'reasonable replacement cost' as earlier provided". With such a mortgage, an "efficiently operating sponsor-builder" might "recover through the mortgage substantially all cash expenditures". The creation and maintenance of an adequate annual reserve for the replacement of equipment was the "principal requirement". *But, corporate mortgagors were not limited as to dividends or rate of return as was the case under 207. Again, there were "no limits as to dividends or rate of return"* (Ex. 13, Ap. 21, 22). This distinction paralleled the difference between § 608 of the National Housing Act (where regulation of rate of return was discretionary) and § 207 (where regulation of rate of return was mandatory) (Ap. 3, 6).

1947: The nation-wide campaign to attract builders to build under 608 roared on (Ex. 24, Ap. 36). It was still recognized by Congress that Title VI had "no place in a long-range housing program", that it would "lend itself to abuses" by attracting speculators who would see a chance of profit without risk with losses "to be absorbed by the taxpayers" (Ex. 10, Ap. 19, Ex. 17, Ap. 26). Congress knew that mortgages insured in some cases amounted to more than 90% of the *actual cost* of the projects including land. Such cases were not unexpected where the mortgages were tied to 90% of "the *estimate* of the necessary current cost" of the project including land (Ex. 33, App. 86). As Congressman Patman said in regard to builders under Title VI:

> "There is no risk at all. There is no risk for the private builder for he is guaranteed a profit, the

United States Government guarantees a profit" (Ex. 15, Ap. 24).

With all its drawbacks, Title VI was extended for another year. One minor amendment directed the Federal Housing Commissioner to use every feasible means to assure that the estimates would approximate as closely as possible the actual cost of *efficient building operations* (Ex. 33, Ap. 87). The effect of this amendment was to eliminate the Commissioner's consideration of estimated costs of the *inefficient builder,* but the amendment still left the Commissioner's estimate of costs tied to the costs of the *typical builder* (Ex. 12, p. 29).

The Commissioner continued to gauge the amounts of mortgage insurance by his estimates of the costs of the *typical builder.* His standard was the *typical builder.* His costs were *estimated costs.* Congress recognized there would be "practical disadvantages" if it were to base insurance on *actual* costs rather than *estimated* costs. Chief disadvantage would be the end of the existing system whereby the FHA was making *firm commitments to insure* ahead of construction. Firm commitments were necessary to attract mortgagees. Therefore, the commitments had to be tied to *estimates of costs,* and there they remained throughout the life of 608 (Ex. 33, Ap. 86).

With all its opportunities for large profits, Title VI was a *"major factor in providing needed rental housing"* and was extended until March 31, 1948, upon unanimous recommendation of the House and Senate Conference Committee after a record 2½ minute meeting under the direction of Senator Tobey (Ex. 15, Ap. 25, Ex. 17, Ap. 25, 26). *Section 608 was getting the job done, whereas the prior socialistic practice of direct Government participation in the building field had failed* (Ex. 10, Ap. 18, Ex. 20, Ap. 28).

1948: On March 31st, Senator Taft again attacked Title VI, calling it "*completely unsound*" and violative of "every principle against inflation", and pointing out that a contractor need invest no money but could get all of it from the Government and "build a complete subdivision with no cost to himself and no capital" (Ex. 5, Ap. 14). But Title VI was doing the job, so its continuance was again advocated in Congress (Ex. 20, Ap. 28). Additional impetus to extension was given by the message of President Truman to a special session of the 80th Congress in July of 1948. Therein the President stated that one of the two reasons he had called the Congress back was "to help meet the national housing shortage". He stated "We need more rental housing, especially low-rent housing. We are not getting it" (Ex. 19, Ap. 26, 27).

As a consequence, although those provisions of Title VI dealing with "for sale" housing were dropped, the provisions of Title VI, dealing with "rental" housing, namely § 608, were revitalized by an additional authorization of $800,000,000, and were extended to March 31, 1949 (Ex. 19, Ap. 27, 28).

By this same Act, approved August 10, 1948, the top limit on FHA insured mortgages was changed in three respects:

(1) A cost limitation of $8100 per family unit replaced the prior limitation of $1500 per room.* This effected a substantial liberalization in the law and indeed "took the lid off" for construction of efficiency apartments (Ex. 1, p. 146). *No efficiency apartments are involved in this case.*

(2) A proviso was inserted that the mortgage should not in any event "exceed 90 per centum of the Administra-

* The limit was $1500 per room, with a proviso that the Administrator might increase the limit to $1800 per room where, in his discretion, cost levels so required (Ex. 1, p. 132).

tor's estimate of replacement cost of the property or project on the basis of the costs prevailing on December 31, 1947". This effected the one tightening in the law by setting up another test by which the Commissioner should measure and limit his estimate (Ex. 1, p. 146), but estimates, and not actual costs, remained the measure of the loans.

(3) The Federal National Mortgage Association (Fanny May) was created to purchase permanent loans which builders or mortgagors could not sell to conventional lenders. This was a liberalization permitting the Government to make loans as well as to insure them to encourage housing (Ex. 1, p. 142). *No such unconventional loans were involved in this case.*

1949: The housing shortage in many areas of the country continued as acute as in wartime. The increases in population and family units had absorbed the increases in dwelling units (Ex. 22, Ap. 29). In the cities alone there was an immediate need for 1,000,000 rental dwellings (Ex. 21, Ap. 29). Franklin D. Richards, Commissioner, Federal Housing Administration, on July 25, 1949, recommended to Congress the extension of 608 to March 31, 1950, before which time "the transition from the more liberal provisions of Section 608 of Title VI to those of Section 207 of Title II could be effected" (Ex. 23, Ap. 30.) This recommendation confirmed that made by The Housing and Home Finance Administration the year before (Ex. 5, p. 176). Actually Congress did extend 608 for four separate short periods of time, to June 30th, then to August 31st, then to October 1, 1949, and finally to March 1, 1950.

One of the most illuminating pictures of the whole 608 operation was flashed at a hearing before a Subcommittee of the Senate Committee on Banking and Currency in

July of 1949. Much of the revealing testimony is reproduced in Appellants' Appendix, pp. 30 to 78, inclusive.

Witnesses included Franklin D. Richards, Commissioner, Federal Housing Administration; Clyde L. Powell, Assistant Commissioner in Charge of Rent Housing, Federal Housing Administration, and Raymond M. Foley, Administrator, Housing and Home Finance Administration. Senator Long was the chief inquisitor. Several sharp points absolutely fundamental to this case were made, clean and clear. These were:

(1) *Mortgaging Out.* The possibility and the practice of "mortgaging out" were recognized. In other words, it was understood that mortgagors might build for less than the mortgages and receive mortgage proceeds in excess of the actual costs of the projects involved. This is exactly what happened to the Shirley-Duke corporations in the instant case (Ex. 24, Ap. 30, 32, 34, 35, 48, 51, 52, 53, 61, 62, 66, 70, 72, 74, 75, 77).

(2) *Estimates of Costs vs. Actual Costs.* The practice of "mortgaging out" was due primarily to the fact that actual costs might very well be less than the *Commissioner's estimates of costs* made many months before construction (Ex. 24, Ap. 31, 32, 40, 41, 64, 65). The FHA estimates were honest estimates (Ex. 24, Ap. 65) and were revised monthly (Ex. 24, Ap. 56, 58), but estimating is not "a mathematical science" (Ex. 24, Ap. 41). Consequently, although the FHA relied upon its own estimates, and not upon those of the mortgagors, the FHA estimates frequently were higher than those of the mortgagors (due to fear of underestimates and consequent difficulties), and turned out to be more than the actual costs of construction (Ex. 24, Ap. 50, 51, 65). Constant inspections insured the *quality* of actual construction (Ex. 24, Ap. 60).

(3) *Typical Builder.* The practice of "mortgaging out" was also due to the fact that *the Commissioner's estimates of costs were estimates of costs of the typical builder.* An efficient builder could construct for 5%, 8% or 10% less than estimates (Ex. 24, Ap. 49, 53, 62, 74, 75, 76). The practice and the necessity of tacking estimates of costs to the typical builder were completely understood and repeatedly condoned by Congress and the FHA.*

The typical builder was not "the most efficient" and "not the poorest" (Ex. 24, Ap. 49). The FHA dealt with "thousands of fellows" (Ex. 24, Ap. 62). The better than typical builder could make a saving (Ex. 24, Ap. 53). As a matter of fact, the difference between the bid of and the cost to a low efficient builder and a high typical builder would vary from 5% to 8% or 10% (Ex. 24, Ap. 74, 75, 76).

(4) *10% Allowance For Contractor And Architect.* The practice of "mortgaging out" was partly due to the fact that a *total fee of 10% was allowed to the contractor and the architect.* This profit was included in the Commissioner's estimate of the necesary current cost of the completed project, including land, and also in his estimate of the cost of completed physical improvements on the prop-

---

* The Commissioner confirmed this in 1952 when he restated to a Subcommittee of the House Banking and Currency Committee:

> "I think it is essential that your Subcommittee understand the difficulties inherent in an insurance operation which by statute must be based upon an estimate of cost, the estimate of cost upon which the insurance commitment is granted must be made in advance of construction. Moreover, the estimate of cost necessarily must be based upon the cost encountered by typical builders. When estimates are based upon costs of typical builders, those builders who are more efficient operate at an advantage, while those builders who are less efficient operate at a disadvantage. This is clearly demonstrated by the fact that even when construction work is put out at competitive bids, the bids actually received will vary widely" (Ex. 2, Ap. 12, 13).

erty, excluding land. Hence, a profit of 10% was automatically guaranteed (Ex. 24, Ap. 33, 40, 45, 47, 48, 63, 64, 65, Ex. 31, Ap. 82, Ex. 32, Ap. 83, 84), consisting ordinarily of a 5% fee for the architect and a 5% fee for the builder (Ex. 24, Ap. 40). Of course, this procedure guaranteed a 10% profit which could be left in the job, in the sense that no cash had to be advanced therefor.*

(5) *Value of Land.* The practice of "mortgaging out" was due partly to the fact that *the Commissioner's estimate of the value of land was based on the land ready for use, and not on the actual cost of land* to the mortgagor. The mortgagor was not even required or requested to state the actual cost of the land. Hence, a profit at this point was usual ** (Ex. 24, Ap. 41-45, 63, 66, 70, 72, 73).

(6) *3% Allowance for Overhead.* The practice of "mortgaging out" was due partly to the fact that an overhead allowance of 3% was generally made. Half of this ordinarily could be saved, thereby guaranteeing another profit (Ex. 24, Ap. 40, 41, 72).

(7) *Income vs. Capital Gains.* The practice of "mortgaging out" was recognized by Congress when it attempted to consider these profits as income and not as capital gains (Ex. 24, Ap. 54). The passage of the "Collapsible Corporation Act" on September 23, 1950, evidenced Congressional understanding at that time of the windfall situation, even though that Act was not aimed at the exact situation

---

* This profit was "left in the job", with the knowledge of the FHA, by the Shirley-Duke corporations in the total sum of $1,252,546 (S. D. Exs. 4a-f, Ap. 130).

** With the full knowledge, consent and approval of FHA, the six Shirley-Duke corporations made a profit exceeding $500,000 on the land alone, representing the difference between the actual cost of the land ($178,000) (Ex. 12, p. 136) and the FHA fair market value of the land ready for use ($687,400) (S. D. Exs. 4a-f, Ex. 69A, p. 3, Ap. 152).

here (64 Stat. 934, Internal Revenue Code § 117(b), 26 U. S. C. A. (I. R. C. 1939) § 117(b).

(8) *Emergency and Temporary Nature of Section 608.* Section 207 of the National Housing Act was not sufficiently attractive to builders to obtain the volume of defense housing and of veterans' housing which Congress desired. Section 608 was passed to meet this need. It was never considered "a permanent type of institution". It was subject to abuse. But it did do the job. It supplanted 207 and accomplished results which 207 had failed to accomplish (Ex. 24, Ap. 31, 35, 39).

In July of 1949, before the Senate Subcommittee on Banking and Currency, the FHA officials acknowledged that the following profits could be made by a mortgagor operating through an efficient builder under Section 608:

(a) Builders' and architects' fees	10 %
(b) Savings in overhead	1½%
(c) Gain between actual cost of land and FHA estimate of value of land ready for use	1½%
(d) Efficiency in construction, 5%, 8%, or 10%	10 %
Total possible savings recognized by FHA	23 %

Shirley-Duke savings, profits and distributions were within the limits probed by Senator Long and admitted by the FHA officials.

Moreover, one other possible source of profits was overlooked by Senator Long but was tapped legitimately by the Shirley-Dukes. The FHA estimated and allowed interest charges of more than $1,000 a day for 14 months from the dates of commitment, as part of the costs of con-

struction. However, the Petitioners completed many of their units in 8 months, and all of their units in 15 months. The interest they were allowed was $415,380 (S. D. Ex. 4a-f).

Senator Long and the FHA officials saw "nothing wrong" in profits of the kind outlined above. They felt "the laborer is worthy of his hire" (Ex. 24, Ap. 77).

1950: Applications for mortgage insurance came piling in. Ultimately more rental units were built in 1950 under 608 than in any other year at a total cost of over a billion dollars (Exs. 28, 29). The applications exceeded the then existing authorization, and the FHA announced it would accept no applications after February 21, 1950. Congress, with its eyes wide open, by act approved April 20, 1950, increased the authorization half a billion dollars and approved mortgage insurance under 608 for applications received by the FHA before March 1, 1950 (Ex. 1, p. 184).

During the debates prior to this last extension of 608, several Congressmen weighed the merits and demerits of the proposition. Senator Long again pointed out that builders were building projects at "anywhere from 80 to 70 cents on the dollar of the estimated cost, *and are pocketing the difference*" (Ex. 26, Ap. 79). The Senator urged that, before the last authorization was granted, the mortgages insured should be based on *value* rather than on *estimated costs* so that the builders would thereby be required to have *some cash or equity* investment in their projects. He failed in his plea (Ex. 26, p. 3376). Other Congressmen apparently felt the benefits of the law still outweighed its burdens (Ex. 26, Ap. 79, 80, Ex. 27, Ap. 80).

With full knowledge that efficient builders could and did build for less than the Commisioner's estimated cost

of the structures, and therefore for less than the amounts of the mortgages, and that efficient builders could and did pocket the savings, Congress authorized the last $500,000,000 of FHA mortgage insurance under 608.

Senator Sparkman later pleaded to the Capehart Committee:

> "Mr. Chairman, I think the practice was wholly bad . . . but in all fairness to the record, I believe the staff ought to go back and examine the minutes of this committee, and you will find that *as early as 1949, 1950 and 1951, protest was being made before this committee that this very practice was being carried out.* Senator Long offered an amendment and the committee refused to accept the amendment. . . .
>
> "I don't say that in trying to cover up the practice . . . I believe it was bad, *but I just don't believe we ought to 'take a holier than thou' attitude when the matter was called to our attention* and one of our own Members offered an amendment to correct it, *not once but several times,* and the committee declined to accept the correction." (Ex. 12, p. 304). (Italics supplied).

In 1951-1953, Senator Long continued his attacks upon 608 in the Congress, stating:

> "We know as a practical matter that contractors sometimes have obtained a guaranty of as much as 150 percent of the actual cost. The sponsor of the project takes no risk in such a case. He reaps all the profits and the Government takes all the loss, if there is a loss." (Ap. 84).

Senator Douglas and Senator Maybank joined him in stating, respectively,:

> "What we have developed under Section 608 . . . is a system of public risks and private profit . . . FHA has been moving in the direction of the taxpayers assuming all the risk and the builder not only getting

> the profit from the building, which is legitimate, but a big profit from the mortgage as well". (Ap. 83, 84).

and

> "I know that the Section 608 program was subject to much abuse. . . . In some instances contractors may have, no doubt, made as much as 120 percent."

Yet Title II, the permanent insurance law, still did not attract the construction of sale and rental housing. By act approved September 1, 1951, Congress added another emergency title, Title IX, to the National Housing Act. This title included Section 908, which was intended to pick up the slack left by the termination of Section 608.

In 908 Congress returned to the "valuation basis" for mortgages to be insured by FHA. It discarded as a measure for the mortgages the Commissioner's *estimate of necessary current cost* of the project, including land. It adopted as the measure for the mortgages the Commissioner's *estimates of the value of the property or project* when completed. This change in policy was strenuously advocated in Congress, and the contrast with the policy under 608, with which Congress was fully acquainted, was highlighted by Senators Maybank, Douglas and Long (Exs. 30, 32, Ap. 81, 83, 84).

Also in 908, Congress incorporated clear and specific language (which the FHA now claims was implied in 608 all along). This language provides that the mortgagor shall certify that the actual cost of the physical improvements upon completion equal or exceed the mortgage loan, or, shall *certify the amount by which the mortgage loan exceeds the actual cost of the physical improvements, and shall apply this latter excess within 60 days to the reduction of the principal of the mortgage.* Moreover, the Commissioner is required to construe the term "actual costs"

to exclude "kickbacks, rebates, and *normal trade* discounts" (Ex. 1, p. 66, Ap. 7).

Similar certification provisions were incorporated in Section 803 of the National Housing Act by Public Law 94, 83rd Congress, approved June 30, 1954. (Ap. 6-7).

STATEMENT OF THE CASE

(Continued)

History of the Shirley-Duke Corporations

1. APPLICATIONS

Early in 1949 the sponsors of the proposed Shirley-Duke corporations applied to Investors Diversified Services, Incorporated, for construction loans and for permanent loans in connection with the Shirley-Duke projects. IDS agreed to make the construction loans and on the 10th day of March, 1949, the sponsors, as proposed mortgagors, and IDS, as proposed mortgagee, applied to the FHA for insurance of the permanent mortgage loans (S. D. Ex. 2). These applications requested total insurance of $14,451,800 for the permanent mortgages, that is, for the mortgages to be placed on the properties after construction. In other words, the applications did not request insurance during construction. Therefore, to a limited extent, the actual construction loans made by the mortgagee were conventional loans which the FHA was not requested to insure.

The applications contained accurate descriptions of the exact properties intended to be security for the mortgages, and included "preliminary drawings" and "outline specifications" in sufficient detail for the preparation of accurate costs estimates by the FHA (S. D. Ex. 9a-f).

2. COMMITMENTS

The FHA issued its commitments to insure permanent loans on the Shirley-Duke projects on the following respective dates: Section 1, June 2, 1949; Section 3, June 6, 1949; Section 4, June 7, 1949; Section 5, June 27, 1949; Section 2, June 30, 1949; and Section 6, July 15, 1949 (S. D. Exs. 3a-f, Ap. 155-163). All the commitments were based on the FHA's own estimates of cost and were commitments to insure first mortgages upon the land, structures and other improvements included in the six proposed projects for the total sum of $13,846,000, or $605,800 less than the amount applied for (S. D. Exs. 3a-f).

Attached to each commitment were four sheets comprising a "Project Analysis", whose dates were approximately those of the dates of commitment (S. D. Exs. 3a-f, Ex. 69, Ap. 152). The Project Analyses contained an estimate of income and of annual operating expenses for the six Shirley-Duke projects, thereby reflecting partially the capitalized value of the projects. The Project Analyses also contained estimates of the replacement cost of the properties as of December 31, 1947, ($15,756,617), and of the 1949 replacement cost of the property ($15,384,849). Finally, the Project Analyses contained a "determination of maximum insurable mortgage" in each case. This determination involved five calculations, namely:

1. Total for all physical improvements, carry charges and financing (1949 costs): $14,679,949.

2. 90% of total estimated replacement costs of property: as of June-July, 1949: $13,846,361 (being 90% of full estimated replacement cost of $15,384,849).

3. Amount based on limitation as to debt service ratio: $14,768,564.

4. Amount based on limitation of $8100 per unit: $17,058,600.

5. Amount of mortgage insurance applied for: $14,451,800.

In each case the maximum insurable mortgage was the lowest of these five calculations. As to Sections 1, 4 and 5, the lowest calculation was the mortgage applied for. As to Sections 2, 3 and 6, the lowest calculation was 90% of the total estimated replacement cost of the project.

In its commitments to insure issued in June and July 1949, the FHA protected itself against every act of the mortgagors which it considered would increase its risk or weaken the insured loans or lessen the security of the mortgages or deplete the assets available for the payment of the insured loans. The FHA framed this protection through a comprehensive set of conditions, providing (a) that the FHA have access to the properties and the right to inspect the work (for which it received a fee of ½ of 1% of the mortgages); (b) that the projects be completed strictly in accordance with the drawings and specifications, without unsatisfactory workmanship or defective materials; (c) that the mortgagors file with the FHA copies of their charters, by-laws and minutes of meetings of incorporators, stockholders and directors, observe the Commissioner's approved rent schedule, and be current in all mortgage payments, deposits, mortgage insurance premiums (annually ½ of 1% of mortgages), fire insurance premiums, taxes and assessments; (d) that the mortgagors establish and maintain reserve funds for replacements and give bonds or escrow agreements against latent defects, faulty workmanship and defective materials; and (e) that each mortgagor furnish proof that it had no unpaid obligations contracted in connection with the mortgage or the property "except obligations secured by property or col-

lateral owned by the mortgagor independently of the mortgaged property" (S. D. Exs. 3a-f, Ap. 156-162).

The Shirley-Duke Corporation fulfilled each and every condition of the commitments, including that for the furnishing of copies of the by-laws. As a matter of fact, they filed the by-laws well in advance and obtained express approval of their terms from the FHA by letter dated June 29, 1949 (S. D. Ex. 21, Ap. 163). These by-laws clearly anticipated and authorized the payment of dividends out of net assets in excess of capital as defined by the law of Virginia (Ex. 50, Ap. 125, 126). § 13-206 of the Virginia Code specifically permitted such distribution (*supra*, pp. 10A, 11A).

3. INCORPORATION

The six Shirley-Duke Corporations were chartered by the State Corporation Commission of Virginia on June 7, 1949, for the purpose of constructing and operating rental housing projects, including projects under § 608 of the National Housing Act (12 U. S. C. 1743) (R. Ap. 57a). Each Corporation issued 200 shares of no par value common stock to its respective stockholders at $5.00 a share, and 100 shares of first preferred stock to the Respondent Commissioner at $1.00 per share (R. App. 59a).

4. CONSTRUCTION

The Petitioner Corporations got the projects under way in the latter part of July 1949 by beginning work on Sections 1, 3 and 4 (Tr. 640). Instead of hiring outside contractors, they used the services of their own sponsors and stockholders, three of whom, Bryan Gordon, Earl J. Preston and Herman W. Hutman, were experienced and qualified builders (Tr. 646, 647, 741, 873). This procedure was followed 90% of the time (Ap. 53). Gordon was responsible for and constructed Sections 1 and 6, Preston, Sections 2 and 3, and Hutman, Sections 4 and 5 (Tr. 646).

All of the six corporations made money on the construction of the six projects. These savings, which might have been hoped for but could not have been anticipated, were due to many reasons. For instance:

Blessed with nearly perfect weather and a splendid labor and material market, the six projects were completed in record time for $11,968,062.39, or for $1,878,937.61 less than the aggregate amount of the loans granted by the mortgagee and voluntarily insured by the FHA. These savings were due (a) to the equities created by leaving architects' and builders' fees in the jobs (*supra*, p. 17); (*supra*, p. 19); (c) to the profit in the land allowed by FHA (*supra*, p. 17); (d) to discounts, mass purchases and general efficiency higher than that of the typical builders upon which the FHA estimates had been based; and (e) to sudden, sharp drop in construction costs between the Spring of 1949 when the FHA estimates were computed and the Fall of 1949 when the purchases were made and the subcontracts were let (S. D. Ex. 14, Ap. 162).

The District Court acknowledged in its opinion that these savings might have been "lavished" on the projects (Ap. 171), and that the Corporations owned the savings and had the ultimate right to them (Ap. 172). The Circuit Court of Appeals likewise recognized that the monies were rightfully earned, owned and possessed by the Corporations (*infra*, 9A).

5. TRUSTS

As the six projects were completed during 1950, permanent trusts, of modified Virginia form, were placed thereon for the total prncipal amount of $13,846,000, bearing interest at 4% per annum, and payable in equal monthly installments over the course of about 33 years (S. D. Ex. 6, *infra*, p. 14A). The trusts provided that the debts might

be prepaid, but if the annual prepayments exceeded 15% of the original indebtedness, then a 4% penalty on the excess would be charged within the first ten years, and a 1% penalty thereafter, plus a 1% penalty to the FHA (*infra*, 18A).

In order to afford additional and adequate protection to the mortgagee and the FHA, the trusts required (a) that the mortgagors place fire and other hazard insurance on the properties (which incidentally amounted to $13,846,287, equaling the full amount of the mortgages) (S. D. Exs. 12a-f); (b) that the mortgagors not assign the rents or any part thereof or demolish or remove any buildings without the written consent of the mortgagee; (c) that the mortgagors not create or permit against the properties subject to the trusts any lien or liens, inferior or superior to the trusts (S. D. Ex. 6, *infra*, 20A, 21A, 22A).

Contrary to the statement in the opinion of the United States Court of Appeals, there was no clause in these trusts requiring that the funds advanced must have been "borrowed for the express purpose of building the apartments" (*infra*, 8A). As a matter of fact, this requirement was inapplicable to the Shirley-Duke trusts and was positively stricken therefrom (*infra*, 22A).

Moreover, the trusts contained no prohibition on the payment of the full mortgage proceeds to the mortgagors by the mortgagee, regardless of whether the actual costs of the projects were above or below FHA estimates. To the contrary, by its own rules and by letter dated September 30, 1948, the FHA directed that the excess of cash over costs be paid to the mortgagors upon completion of the projects (Ex. 39, Ap. 88, 89, Ex. 82, Ap. 154, 155).

6. APPRAISAL AND DISTRIBUTION

Qualified, independent appraisers evaluated Sections 1, 3 and 4 of Shirley-Duke on August 15, 1950, and Sections 2, 5 and 6 on October 5, 1950. Making their calculations

on principles of square footage, cubic footage and capitalization, they fixed the total fair market value of all the projects at a figure of $16,513,200 (Tr. 794, 795, R. Ap. 60a, 61,). This value compared favorably with the FHA estimate of replacement value, namely, $15,384,549, made in March of 1949, especially since construction costs since then, after a dip in the Fall of 1949, had risen approximately 10% (Ex. 14, Ap. 162).

The Respondents offered no evidence to refute the evaluation made by Petitioners' witnesses, and in fact the Respondents could not have done so without impugning their own estimates of costs made in May of 1949, their own valuations of the completed structures for hazard insurance purposes (S. D. Ex. 12a-f), and their own 1952 valuation of the capital stock of Sections 4 and 5 at $1333 per share (S. D. Exs. 19, 20, Tr. 662, 663, 665).*

After the appraisals of August and October 1950, the Directors of the Shirley-Duke Corporations formally revalued the Corporations' assets in accordance with the appraisals, and on December 11, 1950, they authorized distribution to the stockholders, out of net assets in excess of capital, an amount which included the difference of $1,878,937.61 between the amount of the mortgages and the actual costs of the projects. It is the distribution of this sum which is involved in the insant case.

The Corporations had acted openly in regard to the distribution. They had obtained beforehand from the

* During the year 1952 the Directors of Sections 4 and 5 of Shirley-Duke requested approval from the FHA for the acquisition by each of said corporations, with corporate funds, of 15% of the outstanding stock, namely, 30 shares out of 200 shares, by each corporation, for the sum of $40,000, or $80,000 for the two corporations. The FHA considered these requests, analyzed the financial status of the corporations and approved the purchase, at $1333 a share.

Bureau of Internal Revenue a ruling that the distribution would be a capital gain (Ex. 47, Ap. 112). The Corporations reflected the distribution in financial reports filed with the FHA for the years for and after 1951 (S. D. Exs. 23a-f, 26, 27). The Corporations sent to the FHA checks representing the preferred stockholder's share of the distribution, at the rate of $5.00 per share (S. D. Exs. 23a-f). The Corporations knew that the acceptance by the FHA of the preferred stockholder's dividend, and the implicit approval therein of the common stockholders' dividend, was in keeping with its practice in other cases. For instance, in the Elisabeth Apartments case the FHA approved dividends paid out of net assets in excess of capital, determined after reappraisal, where the actual cash involved had been derived originally from mortgage proceeds and represented the excess of the mortgage over the cost of construction.*

MISCELLANEOUS

The six Shirley-Duke projects are located on the southerly slope of Seminary Hill in Alexandria, Virginia. They comprise six sections, 200 buildings and 7,910 rooms.* Three-fourths of the units are two bedroom apartments. They lie adjacent to excellent highways, a neighborhood shopping center and a new elementary and high school. The monthly rentals are among the lowest in the Washington metropolitan area, running from $66.00 for one bedroom units to $77.50 for two bedroom units, including heat, light and water.

From the beginning the average mortgage of $6550 per family unit was well below the $8100 limit authorized by

---

* In the *Elisabeth Apartments* case the laws of New York specifically permitted such a dividend, just as the laws of Virginia specifically permit such a dividend here (Ex. 45, Ap. 107, 111).

* The commitments called for 2,106 apartments with 7,880 rooms. Actually 2,113 apartments were built containing 7,910 rooms.

Congress. And by making all payments on time, the corporations have reduced the mortgage loans by nearly $1,500,000 and have built up unmortgaged assets in cash or its equivalent of over $1,250,000, while spending more than $150,000 for capital improvements and over $400,000 for FHA mortgage insurance premiums.

The Shirley-Duke corporations have made all payments due upon their mortgages, have set aside all replacement reserves and have established all other security required by the mortgages. The buildings are in excellent condition and fully occupied. The mortgagee has suffered no loss to date and will sustain none in the future. The FHA, insurer of the mortgages, has incurred no liability and has not shown or been able to show that it runs any risk of liability in these cases. Here there is neither loss, nor probability nor expectancy of loss.* The mortgagees hold exactly the security they were intended to hold under the deeds of trust. The contingent obligations of the FHA are protected exactly as they were expected to be under the commitments made in 1949. The chief differences resulting from the passage of time are that the projects are now in fact successfully constructed, are in excellent shape, are filled to capacity, have a record of 7 years successful operation and are guaranteed a bright future.

---

* Disastrous losses to the FHA occur where the actual costs of projects exceed the estimated FHA costs and where the builders, for lack of capital, are unable to finish the projects. Such was the situation in *Levin* v. *Stratford Plaza* (Md. 1950), 76 A. 2d 558, where the mortgagor failed in his hope to construct a project for less than $8100 per unit.

ARGUMENT

SUMMARY

The Distribution to Shirley-Duke Stockholders of December 11, 1950, Was a Proper Distribution of Net Assets in Excess of Capital, Legally Acquired and Legally Possessed. The Distribution Was Authorized by the Law of Virginia, Was Permitted by Charter, Was Sanctioned by By-Laws, Was Approved by FHA Rules and Practices, Was Ratified by the FHA and Was Consonant With Knowledge and Acts of Congress.

The above Summary of Argument will be treated under six main headings in order to parallel the six issues outlined under "Questions Presented".

Meanwhile, Petitioners cannot refrain from comment upon the futility of the proceedings which the FHA contemplates and which the Petitioners seek to enjoin, namely, the replacement of the existing directors of the corporations. By this maneuver, the FHA desires to have the new directors force the stockholders to pay back to their own corporations monies which were distributed to the stockholders by the existing directors' actions of December 11, 1950.

The FHA cannot recover the distribution itself, for it has lost nothing and is entitled to regain nothing. The FHA cannot compel the corporations to apply the distribution on the mortgages (Opinions of the Courts Below, Ap. 172, *infra* 9A). The FHA cannot lower the rents in the Shirley-Duke projects even if the new directors recover the distribution. *Dinkes* v. *Glen Oaks Village* (N. Y. 1954) 132 N. Y. S. 2d 138. Both the District and Appellate Courts held that Petitioner corporations were entitled to earn the profits they did earn and to keep those profits (Ap. 172, *infra*, 9A). Indeed the corporations might have "lavished" the profits on the project (Ap. 171). If the Petitioners fail in their cause, then the stockholders will take money from their individual pockets and put it in their corporate pock-

ets subject to non-existent escrow agreement of undefined terms.

I.

The Distribution to the Shirley-Duke Stockholders Was Made From Net Assets in Excess of Capital, Resulting From Valid Appreciation in Value of Corporate Properties. Such Distribution Was Permitted, and Not Prohibited, by:

(a) Article V(a) of the Charters.

(b) Article IV(b of the Charters.

(c) Pertinent Statutes and Decisions.

I(a).

Article V(a) of the Shirley-Duke Charters Did Not Prohibit the Distribution. Article V(a) Did Not Even Refer to or Concern the Assets Distributed.

Article V, as pertinent to this case, reads:

> The Corporation shall not without prior approval of the holders of majority of the shares of First Preferred Stock, . . . (a) *assign*, transfer, *dispose* of or encumber *any real or personal property, including rents, except as specifically permitted by the terms* of the *mortgage* or deed of trust, (b) *remodel, reconstruct, demolish or subtract from the premises constituting the project and subject to such mortgage* or deed of trust . . . (e) *consolidate or merge the Corporation* . . . or *effect any changes whatsoever in its capital stock* except as herein expressly permitted; *alter or amend the Certificate of Incorporation* or *fail to establish and maintain reserves* as set forth in this Certificate of Incorporation." (Ap. 120).

The true purposes of Article V in general, and Article V(a) in particular are:

(1) V(a) was intended to apply and did apply only to the real and personal property secured by the mortgages. Like V(b), it was not intended to cover and it did not cover assets unsecured by the mortgages, and was not

intended to cover and did not cover excess funds realized from the proceeds of the mortgages. If V(a) applied to unsecured property, then the mortgagee and the FHA would be in the anomalous position of having tighter controls over unmortgaged assets than over mortgaged assets.

(2) V(a), like V(b), was intended to make it clear that any violation of the provisions of the mortgages would likewise constitute a default under the charter.

(3) V(a) was intended to permit transfer or other disposition of parts of the mortgaged property as specifically permitted by the terms of the mortgages, even *without approval of the* FHA as preferred stockholder (Ap. 137).

(4) V(a) was intended to permit transfer or other disposition of parts of the mortgaged properties, even though not specifically permitted by the terms of the mortgages, *with the approval of* FHA. On many projects, as a practical and unforeseeable matter, it was necessary to release portions of the mortgaged property, and V(a) protected the trustees and the mortgages by permitting releases without endangering the security of the mortgages.

(5) One purpose pervades Article V, including V(a), V(b) and V(e), namely, the purpose to keep the mortgaged property, real and personal, as well as the *capital* of the corporations, intact. V(e) prohibits any changes in *capital*. It does not prohibit any changes in net assets in excess of capital. If the FHA had intended to control net assets of capital as well as capital, it could have inserted in V(e) a few well chosen words to do the job.

(6) V(a) carried into effect a provision of the FHA Rules to safeguard the control of rents by prohibiting the transfer of title of the project to any other corporation. This control of rents fulfilled the express purpose of Congress when it amended Title VI of the National Hous-

ing Act in 1946, namely, "to increase the supply of housing accommodations available to veterans of World War II at prices within their reasonable ability to pay".*

In the District Court Respondents apparently agreed with Petitioners that V(a) referred only to the mortgaged property, for, in brief and argument, they abandoned the defense that V(a) prevented distribution of unmortgaged assets. However, the Respondents have readvanced the argument since the Trial Judge interpreted V(a) as a "broad, deliberate and studied denial of the *jus disponendi*", and construed the reference to the mortgage as "merely to exempt the foreclosure powers from the force of V(a)" (Ap .169). This construction was affirmed by the Court of Appeals although it is contradictory to the very purpose of the mortgage and the power of the mortgagee,* and is contradicted time and time again, in place after place, by practices of the FHA, by provisions of the FHA rules and by provisions of the controlling documents drawn by FHA, including the commitments and trusts. Some of the inconsistencies are:

---

* The Court of Appeals referred to the right of the FHA to "police" corporate activities (*infra*, 2A). The extent of the "police" power of FHA is both *established* and *limited* by the rules. The conditions in the trusts, in the commitments, and in the charters are authorized by the Rules, and if not so authorized are void. The charters were not intended to include, and did not include, sleeper clauses conferring "police" powers on the FHA.

* The foreclosure power is not a right of the mortgagee which can be granted or withheld by charter. It is a power sired by law and foaled by the mortgage. It is a power which cannot be mutilated by the FHA through any means, much less through the charter of the mortgagor corporation. It is a power which the mortgagee could enforce even if the charter had attempted to prohibit foreclosure. Yet the Trial Court's opinion means, in effect, that Article V(a) would have prohibited foreclosure but for the saving words "except as specically permitted by the terms of the mortgage or deed of trust" (Ap. 167, 169).

(1) The Courts hold that V(a) limits the rate of return. Yet the FHA in its sales pamphlet emphasized that under 608 there would be no such limitation (Ap. 21), and in 1949 recognized that it practiced no such limitation (Ex. 24, Ap. 30-78, Ex. 45, Ap. 107-111, *supra*, 19). The law required no such limitation (Ap. 3, 6). The Rules, dealing with detailed itemized types of regulations, expressly omitted any such limitation (Ap. 90, 92-94).

(2) FHA Rules provided for release of parts of the mortgaged property with FHA approval, thereby implying that unmortgaged property could be disposed of without FHA approval (Ex. 39, Ap. 89).

(3) FHA Rules required disbursement of the entire principal amount of the mortgages to the mortgagors, implying that this disbursement must include mortgage proceeds in excess of costs (Ap. 88, 89, 147). In letter of September 30, 1948, the FHA expressly directed this practice to be followed (Ex. 82, Ap. 154, 155).

This letter of September 30, 1948, itself suffices to explain why the Respondents have abandoned their claim that the mortgagors were not entitled to receive the mortgage proceeds in excess of construction and other costs. Because of this letter, the Respondents admitted that the Petitioners were entitled to *earn, receive* and *possess* the excess proceeds. Both courts below reached the same conclusion (Ap. 172, *infra*, 9A). The Respondents admission and the Courts' decisions narrow the question to the mortgagors' right to *distribute* these proceeds.

In 1956 the FHA again returned to and confirmed the practice which the Petitioners contend was its practice all along, namely, to permit the payment of dividends or other

distributions from surplus cash or other net assets in excess of capital.*

(4) The FHA Rules and Commitments provided that after receipt of final payment of the mortgage proceeds the mortgagors must have no outstanding project obligations, *except those secured by property owned by them other than the mortgaged property,* obviously implying that they could and would own, encumber and dispose of property other than the mortgaged property (Ap. 89, 158). Moreover, the mortgages themselves prohibited any other liens, superior or inferior, against the mortgaged property, but did not prohibit liens on other estate owned by the mortgagors (*infra,* 22A).

(5) The FHA Regulatory Agreements shed light on the true meaning of V(a).* The language of Section A(3)(a) of Form 2466 of the Agreements is identical with the language of V(a) in the Shirley-Duke charters. Section A(3)(a) prohibits assignment, transfer, disposition or encumbrance of real or personal property except as speci-

---

* This practice was authorized by letter of August 17, 1956, and by a new model form of charter attached thereto and containing a clause comparable to V(a). True, the new charters contained a specific prohibition against payment of dividends from borrowed funds. Yet the very inclusion of this positive prohibition is proof of FHA's conviction that the charter clause, comparable to V(a), was itself not intended and was not adequate to prevent the distribution.

* Prior to December 19, 1947, the FHA did not regulate Section 608 projects involving mortgages of $200,000 or less, whether the mortgagors were corporations or individuals or were building one or several projects. As of December 19, 1947, the FHA changed the Rules to provide for the *same regulations* of all projects (S. D. Ex. 10, Ap. 163), though by *different means,* namely, the corporate mortgagors by Rules and Charters issued pursuant thereto and individual mortgagors by Regulatory Agreements. Where the mortgages were $200,000 or less, the mortgagors might be individuals or corporations. Where the mortgages exceeded $200,000, the mortgagors must be corporations (S. D. Ex. 10, Ap. 163).

(Form 2466, Ap 97)

fically permitted by the mortgage. The FHA control through this section is identical with its control through V(a). Yet, it would be absurd to argue that the FHA was entitled to regulate an individual's property, other than the mortgaged property. For obviously the FHA could not regulate an individual's home or indeed any of his real estate except the mortgaged real estate. Therefore, under the identical language of V(a), the FHA could regulate only the mortgaged real estate.*

Moreover, the Regulatory Agreements contain no restrictions upon the individual's use of funds, whether these funds come from rents or mortgage proceeds. The individual could and did pocket the excess of mortgage proceeds over costs. Operating under identical language, a corporate mortgagor should and did have identical privileges.

Furthermore, Form 2466(a) of the Regulatory Agreements, which regulates sales of projects by individuals, applies only to the transfer, disposition or encumbrance of "any of the real property encumbered by the insured mortgage". Since this regulation applies only to mortgaged property, then the comparable charter regulation, namely V(a), likewise applies only to mortgaged property.

---

* In this same connection Article III(d) of the Shirley-Duke Charters empowers each corporation to construct and operate a rental housing *project* or *projects* (Ap. 115). One of the corporations might operate two projects, one project under a mortgage insured by FHA and the other project under a mortgage not insured by FHA. According to the interpretations of Article V(a) by the Courts below, both projects would be subject to the control of FHA. This would be a palpably unreasonable consequence. The Court of Appeals apparently labored under the delusion that the mortgagor corporation could not engage in any other business than the building and renting of the very project for which FHA insured loans were obtained (*infra*, 4A).

(Form 2466A, infra 25A)

Finally, when an individual mortgagor completes, operates, and then sells his 608 project, he is completely released from the bond and mortgage, and the FHA cannot prevent him from pocketing and spending the total amount of his construction profits and mortgage loan savings and net rents. Therefore, the FHA, with regulatory powers over corporations, which are identical with and no greater than those over individuals, cannot prevent corporate mortgagors from pocketing and distributing profits, savings and rents.*

(6) The FHA commitments to insure fixed the estimates of costs, fixed the total advances to be made by the mortgagee and to be insured by the FHA, reserved to the Commissioner the rights to inspect the properties and limited the FHA's obligation to the extent of advances approved and certified by the Commissioner (Ap. 155-162).

---

*It is respectfully submitted that the Courts below both missed the significance of these analogies between Article V(a) of the charters and Paragraph A(3)(a) of the Regulatory Agreements. For instance, the Court of Appeals, in speaking of the protection of the insurer of the trust says,

> "It is no answer to say that such protection is not accorded in the case of loans to individual mortgagors; for, in the case of insured loans to individuals, the F. H. A. protects itself by an appropriate agreement directed to that form of transaction. Furthermore, funds received by an individual increase his net worth and thus add to his ability to repay the loan. Funds received by a corporation have this effect only so long as they remain the property of the corporation" (*infra*, 8A).

Of course funds received by an individual increase his net worth, until he disposes of them. The same language which leaves him the privilege of spending his profits affords a corporation the identical privilege. Also, note the comment of the District Judge.

> "Were the borrower a person and not a corporation, the result would not be different; for undoubtedly he would be restrained by contract just as the corporate borrower is now restrained by its charter" (Ap. 171).

As demonstrated above, the individual borrower is not restrained. The corporate borrower likewise should not be and is not restrained.

(7) Under the Rules and the mortgages, the mortgagors are obligated "in order to more fully protect the security" to pay to the mortgagee in advance sums sufficient to cover mortgage insurance premiums, hazard insurance premiums and taxes, as well as principal and interest (Ap. 142, 143), and to accumulate reserves for replacements (Ap. 90-93). The positive requirement to put up these funds as additional security for the mortgages negatives any requirement to hold other estate as additional security for the mortgages.

Based on the foregoing uncontroverted and uncontrovertible facts, the mortgagors were entitled to receive, use and distribute the excess mortgage proceeds. And withal, the FHA has not been injured in any way, manner, shape or form. The quantity and quality of labor and materials contracted for by FHA and inspected and approved by FHA went into the buildings. The mortgagees paid over, with FHA's consent, certain amounts of money for which the lands and buildings in question stand as security. All parties have exactly the security they anticipated. In this case the FHA seeks to go beyond the contract of the parties and to seize additional security unintended and indeed unneeded.

I(b)

Article IV(b) of the Shirley-Duke Charters Permitted the Distribution of Net Earnings. Article IV(b) Did Not Prohibit or Limit the Distribution of Net Assets in Excess of Capital.

Article IV(b) is a purely *permissive* clause, providing:

> "The net earnings of the corporation, after providing therefrom dividends on First Preferred Stock and on the Second Preferred Stock as hereinabove provided, and all reserves hereinafter required, may be applied each year in payment of dividends to the holders of Common Stock or may be applied or used in the redemption of the Second Preferred Stock as hereinafter provided" (Ap. 116).*

In other words, IV(b) implies that net earnings must be used first for required reserves and for preferred dividends, but then provides that net earnings may be applied to common stock dividends. IV(b) is permissive, not restrictive. It requires that certain prerequisites be fulfilled. It then permits net earnings to be used for dividends. It does not restrict dividends to net earnings. It does not prohibit payment of dividends from net assets in excess of capital.

And the Appellants were empowered specifically by the law of Virginia to distribute their net assets in excess of capital to their stockholders. Section 13-206 * of the Virginia Code of 1950 provides:

> "The board of directors of every corporation shall, unless otherwise provided in its charter . . . have power to declare and pay dividends upon the shares of its capital stock out of its net earnings, *or out of its net assets in excess of its capital. . . .*"

The General Assembly enacted this statute in 1932, following the lead of New York (1923) and Delaware (1927 and 1929) in adopting laws expressly permitting payment of dividends from net assets in excess of capital as well as from net earnings (N. Y. Laws 1923, Ch. 787, now cited as Stock Corporation Law, Sec. 58, and 36 Del. Laws 1929, Ch. 135, Sec. 16, now cited as 8 Del. C. and Ann. Sec. 170).

These modern statutes, frequently, referred to as "impairment of capital laws", are based upon the theory that as long as the capital of the corporation is not impaired, dividends may be declared. The 1956 revision of the Virginia Corporation Law carries forward the principle that net assets in excess of capital are a legal source of

---

* Contrast a restrictive clause such as Wisconsin Statutes, Code Sec. 18.208, which provides that a "dividend shall be paid . . . only out of net proceeds . . .". *Hamilton Mfg. Co.* v. *United States*, (C. A. 7th Cir. 1954), 214 F. 2d 644.

* Sections 13-206 and 13.1-43 of the Virginia Code of 1950 are set out in full (*infra*, 10A, 11A, 12A).

dividends. Section 13.1-43 of the Virginia Code of 1950, effective January 1, 1957, provides:

> "(a) Dividends in cash or property may be declared and paid . . . only out of unreserved and unrestricted earned surplus of the corporation or out of capital surplus, howsoever arising".

Indeed the effect of Section 13.1-43 is to restrict dividends from net earnings unless an earned surplus exists, but to reaffirm the legality of dividends from capital surplus. This is in accord with the modern trend to liberalize dividend practices.

As a matter of fact, since 1836 corporate directors in Virginia have been authorized to declare dividends as long as the corporation was not insolvent or was not made insolvent thereby, in other words, as long as the net assets of the corporation exceeded the value of its capital stock.

> Acts of Assembly 1836-37, p. 78, Sec. 13;
>
> *Slaymaker's Adm's.* v. *Jaffray & Co.* (1886), 82 Va. 346.

The present Virginia law was construed in *United States* v. *Riely* (C. A. 4th Cir. 1948), 169 F. 2d 542. In the words of the Court the only question for it to decide was

> "whether or not, by this Virginia Statute (Sec. 13-206), the taxpayer-corporation was prohibited from paying dividends from its net earnings of $86,412.46 for the year 1937, when these earnings were far from sufficient to restore its capital deficit." (p. 543).

At a time when its capital was impaired, the Court upheld the validity of the payment of dividends from the net earnings. In his opinion Judge Dobie made the following statements which are definitely pertinent to the issues involved in the instant case:

> "At the outset, it should be noted that no question of corporate insolvency is here involved and that corporate creditors play no part in the problem.

> When corporate creditors are fully satisfied, the funds of a dissolved corporation are distributed among the stockholders. Accordingly, *whether or not a dividend is declared, or the funds are held for distribution, these funds, in either event, go to the stockholders.*" (p. 543). (Italics supplied).

Similarly, in the case at bar, there is no question of corporate insolvency involved and the FHA, not being a creditor of the Shirley-Duke corporations, should play no part in the problem. The excess mortgage proceeds belong to the stockholders and were distributable among them. The District Judge, in his opinion, referred to the above quoted paragraph from the *Riely* case observing that "when creditors are affected, dividend distributions are not treated with the same liberality accorded them in inter stockholder controversies" (Ap. 172). This observation of the Court is puzzling. Corporate creditors played no part in the *Riely* case. Corporate creditors play no part here.*

---

* The Trial Court held that the FHA was a "dominating creditor" of the corporations (Ap. 167). Actually, the FHA is a stockholder and an insurer but not a creditor at all, except in the most limited sense that its stock is the next to the last liability of the corporation. As a stockholder its rights are contractual and are determined by the usual rules of construction, including the rule that "the mention of one thing is the exclusion of another". *Tennant* v. *Epstein* (Ill. 1934), 189 N. E. 864; *Ellingwood* v. *Wolf's Head Oil Ref. Co.* (Del. 1944), 38 A. 2d 743. A preferred stockholder is no more a creditor than a common stockholder. *Warren* v. *King* (1883), 108 U. S. 389, 27 L. Ed. 769; *Augusta Trust Co.* v. *Augusta H. & G. R. Co.* (Me. 1936), 187 A. 1. The "rights, duties and privileges" . . . (of the Government are) . . . "no greater than those of any other stockholder". As an insurer, the FHA has a secondary obligation to answer for the debt, default or miscarriage of another. It has no claim against the principal debtor until it has paid the creditor in full. *VEPCO* v. *Carolina Peanut Co.*, 186 F. 2d 816. Even after payment, an insurer of a mortgage cannot rise above the mortgagee. *In re: Miller* (C. A. 2nd Cir. 1939), 105 F. 2d 926; *FHA* v. *Moore* (C. A. 9th Cir. 1937), 90 F. 2d 32.

In the *Riely* case, Judge Dobie continued in his opinion:

> "If a pure analytical approach be employed, clearly there was here no prohibition of the declaration of dividends. The Statute is couched, not in the terms of a negative prohibition, but rather in the terms of positive authorization. Directors of a corporation are empowered to declare and pay dividends 'out of net earnings, or out of its net assets in excess of its capital.' Manifestly, net earnings (on the one hand) and excess of assets over capital (on the other hand) are utterly and absolutely distinct and separate. Either may exist, or not exist, as to a specified period, with, or without, the other." . . .
>
> "As the English language is rationally used, this would seem to imply two separate sources of dividends ((1) net earnings; and (2) excess of assets over capital), each with no relation to, no connection with, the other." (p. 543)

The provisions of Section 13-206 of the Virginia Code of 1950 were incorporated into the Shirley-Duke Charters by virtue of Section 13-3 of the Virginia Code of 1950, which provides:

> "The general statutes of this State, applicable to corporations shall be a part of the charter of every corporation formed under the laws of this State, except so far as the same are inapplicable or inappropriate to the objects of such corporation."

The general law forms an essential part of a charter whether or not it is copied in the charter. And where there is a conflict between statute and charter, the statute controls.

Knights of Pythias v. *Weller* (1896), 93 Va. 605.

Having established that payment of dividends from net assets in excess of capital is authorized by the law of Virginia, Petitioners resume their contention that such pay-

ments are not prohibited by Article IV(b) of their charters. Permissive language similar to that contained in IV(b) was interpreted in the case of *Weinberg* v. *Baltimore Brick Co.* (Sup. Ct. Del. 1955), 114 A. 2d 812. The question in that case was whether the charter of the Baltimore Brick Co. contained a restriction preventing the company from declaring preferred dividends out of current net earnings while there was a capital deficit in respect of the common stock. The charter provided that the preferred stockholders should be entitled to receive each year "out of net earnings of the company" a dividend of 5%. The Delaware law provided that dividends might be declared, subject to restrictions in the charter, either (1) out of net assets in excess of capital or (2) if there were no such assets, out of net profits. The Court, in its opinion stated:

> "And we perceive no reason here for adopting a restrictive construction. *The charter contains no negative or restrictive language of any kind. It is permissive in form.* Nor is there any specific language from which the restriction urged by plaintiff can be inferred. Dividend restrictions are frequently met with, but they are ordinarily carefully spelled out, *e.g.*, a restriction that out of profits a reserve or sinking fund must be established; a restriction that dividends shall be withheld or limited in amount while funded debt is outstanding; and the like." (p. 817) . . .
>
> "Of course, there is nothing to prevent the framers of a charter from expressly providing that no dividends on cumulative preferred stock shall be paid except out of a surplus of assets over capital, or except out of earned surplus. But a self-imposed restriction of that nature, that is, a restriction operative apart from the statute, ought not to rest in implication." (pp. 817, 818)

In the case at bar, the Virginia statute permits payments of dividends from net assets in excess of capital unless otherwise provided in the charters of the corporations. It is not otherwise provided in the charters. Dividends are expressly permitted by the charters from net earnings. Dividends are not prohibited by the charters from net assets in excess of capital. If such a prohibition were intended, it should have been positively stated especially since the Shirley-Duke Charters were modeled on forms prepared by the FHA. As Judge Dobie said in the *Riely* case, *supra:*

> *"If such were the real intention of the statutory draftsman, he must plead guilty to the charge of hideously inept draftsmanship."* (Italics supplied)

In this case if a prohibition against payment of dividends from net assets in excess of capital were intended by the FHA attorneys, they should plead guilty to the charge of "hideously inept draftsmanship".

Petitioners deferentially but emphatically contest the statement in the opinion of the Court of Appeals that "The general rule is that dividends may be paid only from net earnings". There is no such general rule. The case cited by the Court * does not enunciate any such rule but concerns itself with a distinction between profits and capital, not between net earnings and net assets in excess of capital. As amply demonstrated above, the general rule in Virginia is that dividends *are* payable out of net assets in excess of capital. As a matter of fact, by the 1956 revision of the Virginia Corporation Law the declaration of dividends from net assets in excess of capital is made preferable to the declaration of dividends from net earnings for any one year where capital may be impaired as

---

* *Mobile & Ohio R. Co.* v. *Tennessee* (1894), 153 U. S. 486, 38 L. Ed. 793.

a result of such declaration (*infra*, 12A, footnote). This legislative enactment in effect overruled the decision of the Court of Appeals of the Fourth Circuit in the *Riely* case, *supra*, permitting dividends from net earnings.

The basic question involved at this point is "What is the most reasonable interpretation of the meaning of IV(b)?" It is noteworthy that the Petitioners, the Respondents and both Lower Courts disagree in their answers to this question. The Petitioners argue that the most reasonable interpretation indicates that the language is permissive and not restrictive. The District Judge was inclined to agree with Petitioners because he based his decision first of all upon a highly restrictive interpretation of V(a) (Ap. 169, 170). The Respondents abandoned their contention as to the efficacy of V(a) in the District Court and relied upon their argument as to the restrictive nature of IV(b). The Court of Appeals agreed with the Respondents as to IV(b) and with the Trial Judge as to V(a). Clearly, at best, Courts and counsel have shown great doubt as to what the most reasonable interpretation of IV(b) should be. The Petitioners feel, as they will argue later, that doubts in the language should be construed against the party which prepared it, namely, the FHA.

In any event, the burden of proof is upon the Preferred Stockholders throughout this case, to show the impropriety of the distribution. Such burden has not been carried.

Slaymaker's Adm'r. v. *Jaffray & Co.* (1886), 82 Va. 346, 347, 348.

I(c)

The Distribution to Shirley-Duke Stockholders of Net Assets in Excess of Capital Resulting from Unrealized But Valid Appreciation in Value of Corporate Properties is Authorized by Statute Law and Decisions.

STATUTE LAW

Section 13-206 of the Virginia Code of 1950, in effect when the Shirley-Duke distributions were made, provided that dividends may be declared out of net assets in excess of capital (*supra*, 40, *infra*, 10A, 11A). This is a modern statute, commonly known as an impairment of capital law. Since the adoption of impairment of capital statutes in New York, Delaware and Virginia, there has been a definite modern trend, under modern corporation laws, to permit distribution of dividends from unrealized appreciation in corporate assets. Of course, this practice is not permitted in those states which specifically prohibit distribution of dividends from such sources. Naturally, under the old laws limiting dividends to net profits or net earnings, the decisions were in conflict. However, the modern trend permitting distributions from valid but unrealized appreciation is now clearly defined.

Section 13.1-43 of the Virginia Code of 1950, part of the 1956 revision of Corporate Laws, confirms and ratifies the former law to the extent of providing that dividends may be declared only out of earned surplus or capital surplus. In other words, dividends may no longer be declared out of net earnings unless capital remains unimpaired (*supra*, 41, *infra*, 11A, 12A).

Section 13.1-43 is derived from the dividend section of the revised Model Business Corporation Act, prepared by the Committee on Corporate Laws of the American Bar Association, and adopted basically as the corporation law in an increasing number of jurisdictions. The Model Act provides in Section 40, that dividends may be declared and paid only out of unreserved and unrestricted earned surplus. It is noteworthy that both the Model Act and the revised Virginia Statute were based on the Illinois Busi-

ness Corporation Act but expressly omitted Section 157.41(c) contained in the Illinois Act. Paragraph (c) provides that:

> "No dividend, except a dividend payable in its own shares, shall be declared or paid out of surplus arising from unrealized appreciation in value, or revaluation of assets."

The Illinois Act contains a clear, unequivocal prohibition against distribution from net assets in excess of capital resulting from a revaluation of corporate properties. The Model Act and the Virginia Act, just as clearly and unequivocally reject the prohibition and permit the distribution.

From this history of the statutes there should be little doubt as to the legality of the Shirley-Duke distribution under Virginia law. Yet, both Courts below by-passed these statutes in their opinions. The Trial Court held that it did not have before it the question of "what assets are available under the Virginia law for dividends" (Ap. 172). The Court of Appeals stated that, "It is said that the law of Virginia, under which the corporations were chartered, permits the payment of dividends from assets other than net earnings", but the Court failed to declare the Virginia law in a positive manner and failed to recognize this law as authority for the validity of the Shirley-Duke distribution (*infra*, 6A).

DECISIONS

An imposing array of authorities, constituting the great weight of decided cases, both in quantity and quality, recognize the validity of distributions to stockholders from net assets in excess of capital resulting from reappraisal of corporate properties. These authorities now find them-

selves in conflict with the decisions of the District Court and the Court of Appeals in the instant case. For here, the Courts disallow the distribution and say that while the difference between mortgages and costs "were made apparently available for dividends," they "were not available for dividends" (Ap. 165) and that the distribution was "a partial liquidation",* that no net assets could be "liquidated" under the Courts' definition of that term until the mortgage had been paid off, and that "the net assets thus transferred to stockholders constitute mere borrowed capital" (*infra*, 5A). Finally, the Court of Appeals concluded that "In application of sound accounting principles dividends may ordinarily be declared only out of actual earnings or profits and not upon a theoretical estimate of an unrealized appreciation in value of assets" (*infra*, 7A).

The present decision is in direct conflict with decisions of other Courts of Appeal on the same matter. Leading the parade of cases which support the Petitioners' contentions are the following:

Commissioner of Int. Rev. v. *Gross* (C. A. 2nd Cir. 1956), 236 F. 2d 612;

Commissioner of Int. Rev. v. *Hirshon Trust* (C. A. 2nd Cir. 1954), 213 F. 2d 523, cert. den. Oct. 25, 1954, 99 L. ed. 46;

Newfield v. *Oosterhuis* (C. A. 2nd Cir. 1943), 137 F. 2d 437;

Warren v. *United States* (DC Mass. 1948), 76 F. Supp. 587;

---

* This rule would prevent payment of any dividend out of net assets in excess of capital by any corporation as long as a bonded indebtedness existed. The effect on American business corporations, large and small, would be disastrous.

Randall v. *Bailey,* (Sup. Ct. N. Y. 1940), 23 N. Y. S. 2d 173, affirmed unanimously Sup. Ct. Ap. Div. 1941, 29 N. Y. S. 2d and reaffirmed unanimously Court of App. N. Y. 1942, 43 NE 2d 43;

Hayman v. *Morris,* (Sup. Ct. N. Y. 1942), 36 N. Y. S. 2d 756;

Morris v. *Standard Gas & Elec. Co.,* (Ch. Del. 1949), 63 A 2d 577;

Cannon v. *Wiscassett Mills Co.,* (N. C. 1928), 141 SE 344;

Webb City Undertaking Co. v. *Sinclair,* (Mo. 1949), 225 SW 2d 138;

Graham v. *Louisville Transit Co.,* (Ky. 1951), 243 SW 2d 1019.

The *Gross* case, *supra,* is the most recent of the decisions and the most pertinent on the facts. The question involved was whether the distributions, by certain corporations, to stockholders of monies representing the excess of FHA insured mortgages over the cost of construction of 608 projects constituted ordinary income or capital gains. The reasons for the surplus of mortgage monies received by the corporations over the cost of construction and development were very similar to the reasons existing in the *Shirley-Duke* case. Prior to making the distributions, each of the corporations wrote up on its books the value of its real estate by an amount equal to or in excess of its distribution.

Two Judges of the Court of Appeals for the Second Circuit held that the distribution constituted capital gains. One dissenting Judge held that the distribution constituted ordinary income. All three Judges held that the distribution from net assets in excess of capital created by the

revaluation of real estate was valid and proper. Going to the heart of the question, the majority Judges said:

> "It makes little difference whether the cash which was distributed came from 'mortgage windfalls', or mortgage proceeds, or from some other source. The real source of the distributions was the appreciation in the value of the property. If the appreciation had not taken place and been recognized on the books, and the corporations had distributed mortgage proceeds or mortgage 'windfalls', there could not be a clearer case of capital impairment . . . The only thing which made a distribution possible here under New York law was the creation of a surplus by writing up the corporations' assets to reflect appreciation in the value of their real estate" (p. 616).

The dissenting Judge pointed out:

> "If, therefore, we go beneath the surface, we find that realistically considered this was anything but the case of a realty owner investing in capital to improve the premises in the hope of later realized gain. Here the risk was taken over by the Government, and the money was in hand at once. The situation, in other words, was that of an experienced workman realizing proper and adequate payment for the fruit of his toils . . . That they worked through corporations, rather than as individuals, does not change the nature of the gains as being this type of monetary award for services performed, rather than the profits from investments which have turned out well" (p. 619).

Both the majority and minority opinions in the *Gross* case contradict the philosophy and holdings of the Fourth Circuit Court of Appeals in the *Shirley-Duke* case.

In the *Hirshon Trust* case, *supra,* the taxpayer took the position that the market value of the corporation stock was taxable to share holders as dividend income only to the extent of the corporation's earnings and profits, deter-

mined without regard to any appreciation in the value of the stock above its adjusted cost basis. In discussing the question involved, Judge (now Justice) Harlan stated:

> "The capital impairment statutes of some States permit unrealized appreciation to be calculated in determining corporate surplus available for dividends . . ."

The Court concluded that if corporate earnings and profits were to be charged with the appreciated value of a distributed asset, they should also be credited with that value, and that the corporation's stock was taxable to the recipient at its full market value at the time of receipt.

Newfield v. *Oosterhuis, supra,* cited *Randall* v. *Bailey* as authority for the point that the party alleging impairment of capital has the burden of proving impairment of capital. The Court of Appeals affirmed the Trial Court in its finding that no such proof had been made and that, therefore, the payments made by the defendant corporation were allowable.

In *Warren* v. *United States, supra,* the Court recognized the rule of *Randall* v. *Bailey* as the law of New York State.

Randall v. *Bailey* is perhaps the leading authority in the United States on the legality of distribution of net assets in excess of capital realized from reappraisal of corporate properties. The law of New York in effect when that case was decided was the Act of 1923 (Stock Corporation Law, Section 58). Prior to the adoption of this modern statute, the old New York law prohibited directors from declaring dividends except from surplus profits. In interpreting the new law, the Court stated:

> "Before one can determine whether or not capital of capital stock has been impaired, one must determine

what is capital or capital stock. The words to be construed thus are words which have varied and different meanings and express radically different concepts in different connections. *Capital means one thing to an economist, or, perhaps more accurately, different things to different economists, and it has still different meanings to accountants and to business men. It even means different things in different statutes.*" (23 N. Y. S. 2d 179). (Italics supplied)

After reviewing the history of the New York law the Court concluded that the Legislature in 1923 had specifically omitted any reference to surplus or surplus profits for the very reason that by some persons those words were believed to convey the idea of and to be confined to an accumulation of net earnings resulting from completed transactions. In other words, the Court felt that under the modern statute dividends could be paid from net assets in excess of capital or from surplus where it actually existed regardless of its source. In the Court's opinion at p. 182:

"Those statements by our highest court seem to me to make it entirely plain that the terms capital and capital stock in these statutes mean an amount, i.e. a value, of property up to the limit of the number of dollars specified as the par value of paid-up issued shares (or as the stated value of no-par shares), and that when the amount, i.e. the value, of the company's property exceeds that number of dollars the excess, *whether 'contributed by the stockholders or otherwise obtained' is surplus or surplus profits and may be distributed as dividends until the point is reached where such dividends 'deplete the assets,'* i.e. the value of the assets, 'below the sum,' i.e. below the number of dollars, specified as the par or stated value of the paid-up issued shares. In other words, the capital or capital stock referred to in these statutes is the sum of the liability to stockholders, and any value which the

corporation's property has in addition to that sum is surplus. *And I cannot doubt that the words 'otherwise obtained' and 'accumulated,' as used by the court in the cases just mentioned, include an appreciation in the value of property purchased whether realized or unrealized.*" (Italics supplied)

The Court then pointed out that where corporations had made distributions to stockholders on the basis of appreciation in value, such distributions had been held taxable as dividends paid, citing numerous cases. The Court reached the further conclusion that there was not a single case in New York "which actually decides that unrealized appreciation cannot be taken into consideration, or, stated in different words, that cost and not value must be used in determining whether or not there exists a surplus out of which dividends can be paid." (p. 183).

The Court reminded that in a case of this kind the directors must exercise an informed judgment of their own, and that the amount of information which they should obtain, and the sources from which they should obtain it, would of course depend upon the circumstances of each particular case.

In affirming the Trial Court, the New York Court of Appeals pointed out that dividends could be paid in New York when there was no impairment of capital or capital stock caused thereby and when the value of the corporate assets remaining after the payment of such dividends was at least equal to the aggregate amount of its debts and liabilities including capital or capital stock, "in other words, from its surplus." (p. 48).

As recognized in the New York decisions surplus was defined in *Edwards* v. *Douglas* (1925), 269 U. S. 204, 214, 70 L. ed. 235, 240, where Justice Brandeis stated in his opinion:

"The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be 'paid-in surplus,' as where the stock is issued at a price above par. It may be 'earned surplus,' as where it was derived wholly from undistributed profits. Or it may, among other things, represent the increase in valuation of land or other assets made upon a revaluation of the company's fixed property."

The case of *Randall* v. *Bailey* was followed in *Hayman* v. *Morris* (Sup. Ct. N. Y. 1942) 36 N. Y. S. 2d 756. In that case the Industrial Finance Corporation, a Virginia corporation, sought to buy in some of its own 7% preferred stock out of "surplus," which comprised a million dollars worth of good will added to corporate assets by a revaluation not arbitrary but justified by the facts. In its opinion the Court said:

"In the Randall case it was held that unrealized appreciation in value of corporate assets may be taken into consideration by directors in determining whether a corporate surplus exists from which cash dividends may be paid to stockholders. On this feature, it seems to me the Randall case has settled that point beyond further meritable discussion."

Randall v. *Bailey* was followed also in *Morris* v. *Standard Gas & Electric Co.* (Ch. Del. 1949) 63 A. 2d 577. That case also involved the legality of a dividend paid out of net assets in excess of capital after an appraisal of assets by a competent appraisal company. The Court cited *Randall* v. *Bailey* specifically on another point but followed the *Randall* v. *Bailey* principle. The Court found that the directors had exercised reasonable discretion in ascertaining value and stated:

"I conclude that the action of the directors in determining that the net assets were worth at least the aggregate amount of the capital represented by the

issued and outstanding stock of all classes having preference upon the distribution of assets cannot be disturbed on the showing here made. Consequently plaintiff is not entitled to a preliminary injunction restraining the payment of the dividend." (p. 585).

Because of history of enactment of the present New York, Delaware and Virginia statutes, because of their similarity and because of the New York, Delaware and Virginia decisions, it *appears probable that our Virginia courts will follow Randall v. Bailey* when the question there involved is squarely placed before them. It would appear from existing decisions, that in North Carolina, Missouri, Maine and Kentucky, the New York rule will be followed.

In *Cannon* v. *Wiscassett Mills Co.* (N. C. 1928), 141 S. E. 344, there appears this pivotal statement "Manifestly for the purpose of *determining* the amount to be declared and paid as a *dividend, it is necessary that the true value of the assets, in cash, and not mere book value, should be ascertained,* for no dividend can be lawfully declared and paid except from the surplus or net profits of the business." (p. 348).

In *Webb City Undertaking Co.* v. *Sinclair* (Mo. 1949), 225 S. W. 2d 138, a dividend was paid when appraised net asset values, exclusive of good will, were considerably less than the par value of the corporation's stock. However, one year later the stock was sold for more than two and a half times its par value bringing a price which if representing value would have supported the dividend without impairing capital. The law provided that no dividend should be declared or paid at a time when the net assets of the corporation were less than its stated capital or when the payment would reduce the net assets below the stated capital. The Court *allowed the dividend* on the

ground that good will had made up the difference between par value and actual value of the stock.

Graham v. *Louisville Transit Co.* (Ky. 1951), 243 S. W. 2d 1019, 28 A. L. R. 2d 1171, involved a question of payment of corporate dividends out of a surplus arising from consolidation of two former corporations and by a reduction of corporate stock. The Court held that if it looked behind the new corporation to the old, the surplus was earned surplus. If it did not look behind the organization of the new corporation the surplus would fall in the class of paid-in surplus. The Court pointed out that the governing statute, KRS 271, 265, did not limit dividend sources to current earnings but imposed only the restriction that dividends might not be declared or paid if the corporation was insolvent or if the payment would render the corporation insolvent or diminish the amount of its capital. The Court found that a *bona fide* surplus existed based on real values and that the dividend should be allowed.

In its opinion in the *Shirley-Duke* case, the Court of Appeals relied upon three decisions in refusing to follow the rule of *Randall* v. *Bailey* (*supra*, 50). All three of these cases are easily distinguishable.

LaBelle Iron Works v. *United States* (1921), 256 U. S. 377, 65 L. ed. 998, involved the interpretation of a specific statute under which the taxpayer was allowed to charge "invested capital" against income before the tax was imposed. The Court held that the term "invested capital" in that particular statute meant the cost to the taxpayer.

In *Berks Broadcasting Co.* v. *Craumer* (Pa. 1947), 52 A. 2d 571, a Pennsylvania law was involved which required that the amount of unrealized appreciation in value of assets be deducted from the net assets of the corporation

before payment of dividends. After making this deduction which was expressly required by the statute, there were no net assets left for the payment of dividends.

The case of *Kingston* v. *Home Life Ins. Co.* (Dela. 1917), 101 A. 898, was decided under the old law of Delaware, which restricted payment of dividends to surplus or net profits arising from the business of the company. In the instant case, the source of the Shirley-Duke dividends is not claimed to be a net profit arising from the business of the companies, but it is a net asset over and above the capital of the companies.

The entire issue of marking up the value of real estate in connection with corporate mortgages is summed up in Fletcher's Cyclopedia on Corporations, Permanent Edition 1933, Section 9033, page 217, where the author recognizes the *legality* as distinguished from the *business advisability* of the practice, as follows:

> "The statutes of some of the states prohibit the declaration of dividends from profits created by appreciation of assets. Where there is no statutory prohibition and the mark-up is done in good faith, with apparently sound reasons to justify the same, the transaction will usually stand . . ."

II

Both Courts Below Invested Congress With a Positive Intent or Plan to Prohibit Distribution of Excess Mortgage Proceeds Under Section 608. The Clear Indication from the Record Is Contrary to These Holdings. The Deliberations and Acts of Congress Show Positively An Undeviating Purpose of Congress to Obtain Vitally Needed Housing by Offering Enticing Financial Inducements to Mortgagors, and An Awareness of Congress That Efficient Builders Would Build for Lower Costs Than the FHA Estimated Costs for Typical Builders, and That the Resulting Profits Would Be Subject to Distribution. When

Congress Intended or Planned to Prohibit Distributions. It Did So in Explicit Language. Such as That Contained in Sections 207, 803 and 908 of the National Housing Act.

The FHA now claims, and the Trial Court in effect held that a prohibition upon distribution of excess mortgage proceeds was "emphatically implicit in Section 608 (Ap. 170)". The Court of Appeals recognized that Congress knew that "insured loans were in some cases obtained in excess of the value of the property mortgaged".* The Court then held that "this was recognized as an abuse which was to be guarded against, not a practice which was to be encouraged" (*infra*, 8A). The Court did not claim that the practice was guarded against but simply indicated that it should have been. The Court then went on to state that there was "absolutely nothing" in the Congressional history or elsewhere evidencing an intent on the part of Congress to permit the distribution of net assets in excess of capital realized from the proceeds of insured loans. The Court did not contend that there was any evidence whatsoever in the record indicating an intent on the part of Congress to prevent such distributions. And, as pointed out later, the laws of Congress and the rules of the FHA made thereunder must be construed against the Respondents and not against the Petitioners.

The Court of Appeals, in that part of its opinion dealing with Congressional intent, points out that "a subsequent amednment of the statute" (which really involved Sections 803 and 908 of the National Housing Act) provided that any excess of loan proceeds over estimates of costs should

---

* Actually this statement of the Court was erroneous. In many cases the insured loans were in excess of the Commissioner's estimates of costs of typical builders as figured. The Petitioners have not contended and do not contend that they were entitled to loans in excess of the value of the mortgaged property (*infra*, 8A).

be applied on the loan. The Court then made this remarkable statement, "While such application was not required by law at the time the loans here were obtained, there was nothing to prevent it; and this is manifestly what should have been done with the excess" (*infra*, 9A). Partly because of this statement the Petitioners are compelled to assert with respect but with undenied emphases that the *Court decided this crucial point not on a basis of what the law was but on the basis of what the law should be.*

Actually, the real intendment and plan of Congress from 1941 through 1950 was to make use of § 608 to meet a critical national emergency of the first magnitude by inducing construction of housing, especially of rental housing, *by the most alluring financial bait offered in this century by our Federal legislative body.*

Under § 608, from its initial passage in 1942, *the FHA was not required to regulate the rate of return,* and did not in fact regulate the rate of return, in contrast to the requirement and regulation under § 207 (Ap. 3, 6, 21, 22, 90, *supra*, 9).

§ 608 was amended in 1946 so as to permit the FHA to make firm insurance commitments ahead of time by basing the mortgages on *estimates of current cost* instead of an *estimates of replacement cost* (Ap. 4, 5, 86, *supra*, 10). Congress continued to tie § 207 mortgages to estimates of the "value" of the property (Ex. 1, pp. 20, 150, 202).

During 1946 and 1947, armed with the new liberalized § 608 and with the apparent approval of Congress, the FHA conducted a sales campaign designed to wither the resistance of the most timid investor (Ex. 4, Ap. 21, 22). Also with the apparent approval of Congress, the FHA tied its estimates of costs to the costs of *typical builders,*

thereby inviting additional profits by efficient builders (Ap. 87, *supra*, 12, 16).

In 1948 Congress showed that when it intended or planned to tighten the law, it did so by definite and unambiguous language. Accordingly, it added a restriction to § 608 tying the mortgages to 90% of the Commissioner's estimate of replacement costs on December 31, 1947. But, it also made two liberalizations of § 608, one, by raising the cost limitation to $8100.00 per family unit, and, two, by creating, "Fanny May" to finance the most unconventional of the insured mortgages (Ex. 1, pp. 142, 146, *supra*, 13, 14).

Not until after May of 1950, when Congress made a final half billion dollar increase in the amounts of insurance authorized under § 608, was this liberal law allowed to fade into innocuous desuetude (Ex. 1, p. 184).

Moreover, during the long period of its life and effectiveness, the financial loopholes, invitations and dangers of Section 608 were known to Congress. Yet it was the intendment and plan of Congress to continue this law with all its attractions. A first warning was given Congress in 1942 (Ap. 15, *supra*, 9). Further warning came from Senator Patman in 1947 (Ap. 24, *supra*, 11, 12), from Senator Taft in 1948 (Ap. 14, 28, *supra*, 13), and from Senator Long in 1949 (Ap. 30-76, *supra*, 14-18), and in 1950 (Ap. 79, *supra*, 19), and in 1951 (Ap. 84, *supra*, 20). Senator Maybank (Ap. 81, 84, *supra*, 21) and Senator Douglas (Ap. 83, 84, *supra*, 20) joined in the voices of warning and complaint. According to Senator Sparkman, Congressional knowledge of windfalls dated back to 1949 (Ex. 12, p. 304, *supra*, 20). Such knowledge undeniably existed prior to the last $500,000,000 authorization given in May of 1950,

as shown by the statements of Senator Long (Ap. 79, 80, *supra,* 19).

When Congress intended and planned to cut out further windfall profits, it did so by a very simple, clear and completely effective device. § 608 had expired. But Congress amended Sections 803 and 908 (the successor to 608) so as to provide that the mortgagor must certify the amount, if any, by which the mortgage loan exceeded the actual cost of physical improvements and must use that amount to reduce the mortgage.

It is the foregoing type of language which the Trial Court held was "emphatically implicit" in Section 608, (Ap. 170), and which the Court of Appeals held should have control of the disposition of excess proceeds even though it was not in the law (*infra,* 9A). Such was not the case. The mortgage proceeds were used to construct the *exact* rental housing project envisaged by the parties, brick for brick, pipe for pipe, board for board, detail for detail, in quantity and quality of workmanship and material. The parties recognized that actual costs of *typical* builders might total less than estimated costs, and that *efficient* builders would make more savings and more profits than typical builders. Yet no party intended, stated or implied an intention that while these savings could be earned, they could not be distributed.

The contrasts between Sections 608 and 207, with no regulation of rate of return and with mortgages tied to estimates in 608, together with the amendments to 608, and the amendments to 803, 903 and 908, indicated positively that it was the intendment and plan of Congress to permit the earning, use and distribution of savings through efficiencies in construction (Ap. 6, 7, *supra,* 7, 8, 18, 19).

In attempting to ascertain the purpose of a legislature or how the policy of the legislature has been changed or modified from time to time, resort may be had to acts passed both at prior and subsequent legislative sessions. *Great Northern Railway Co.* v. *United States* (1942), 315 U. S. 262, 273, 86 L. ed. 836, 841; *United States* v. *Wrightwood Dairy Company* (1942), 315 U. S. 110, 86 L. ed. 726.

In the *Great Northern* case, the Court stated:

> "But we are not limited to the lifeless words of the statute and formalistic canons of construction in our search for the intent of Congress. The Act was the product of a period, and, 'courts, in construing a statute, may with propriety recur to the history of the times when it was passed'." (315 U. S. 273, 86 L. ed. 841).

Re-enactment of a statute in the same terms is an adoption of the practical construction placed on the previous statute by the Legislature as well as by the executive or administrative departments of the Government. *National Labor Relations Board* v. *Gullett Gin Co.* (1950), 340 U. S. 361, 95 L. ed. 337. *Heald* v. *District of Columbia* (1920), 254 U. S. 20, 65 L. ed. 106 and annotation beginning 65 L. ed. 106.*

As was tersely put by the court in the *Gullett Gin* case:

> "In the course of adopting the 1947 amendments Congress considered in great detail the provisions of the earlier legislation as they had been applied by the Board. Under these circumstances it is a fair assumption that by reenacting without pertinent modification the provision with which we here deal, Congress accepted the construction placed thereon by the Board and approved by the courts." (340 U. S. 366, 95 L. ed. 343).

---

* Charter provisions are subject to this rule. *Dalton* v. *Lelande* (Cal. 1913), 135 P. 54, 56, 57.

On the other hand, re-enactment of a statute substantially changing its phraseology indicates an intent to change the law and enactment of an amendment containing a change in language is presumed to intend a change in meaning. *Great Northern Railway Co.* v. *United States, supra; United States* v. *McClure* (1939), 305 U. S. 472, 83 L. ed. 296; *Spring City Foundry Co.* v. *Commissioner of Int. Rev.* (1934) 292 U. S. 182, 78 L. ed. 1200. 50 Am. Jr. 261-263, Statutes, § 275.

In the *Great Northern* case, referring to the disputed nature of a right of way, the Court said:

> "Since it was a product of the sharp change in Congressional policy with respect to railroad grants after 1871, it is improbable that Congress intended by it to grant more than a right of passage, let alone mineral riches." (315 U. S. 275, 86 L. ed. 842).

In the *McClure* case, where the World War Veterans Act as it affected war risk insurance was involved, the Court found:

> "A deliberate separation of the two parts of the old section—applying a restriction to one and not the other—indicates that a change was intended." (305 U. S. 477, 478, 83 L. ed. 299).

Again, in determining the intent of Congress in reenacting some statutes without change and other statutes with change, resort may be had to the debates and reports of legislative committees and commissions. *United States* v. *Wrightwood Dairy, supra; Spring City Foundry Co.* v. *Commissioner of Int. Rev., supra; United States* v. *Federal Power Commission* (C. A. 4th Cir. 1951), 191 F. 2d 796, 802-805, affirmed 345 U. S. 153, 97 L. ed. 918. 82 C. J. S. 753, Statutes § 365.

Finally, where Congress has the intendment or plan to change a law it should declare its purpose in clear, unambiguous language. *Shwab* v. *Doyle* (1922), 258 U. S. 529, 534, 536, 66 L. ed. 747, 752, 753:

> "If Congress, however, had the purpose assigned by the Commissioner, it should have declared it; when it had that purpose it did declare it. In the Revenue Act of 1918 . . . it provided that the transfer or trust should be taxed whether 'made or created before or after the passage of' the act. And we cannot accept the explanation that this was an elucidation of the Act of 1916 . . . but regard the Act of 1918 rather as a declaration of a new purpose; not the explanation of an old one."

In the instant case, Congress had no intendment or plan to forbid windfall profits. As has been recognized by one Federal Court, Congress was "fully aware" of them. *Choy* v. *Farragut Gardens* (D. C. S. D. N. Y. 1955), 131 F. Supp. 609, 614. Moreover, "the purpose of the FHA was to stimulate housing construction, not to make profits by insuring sound loans. . . . This purpose presumably was furthered by making possible such profits of speculators with little capital and no credit". *Levin* v. *Stratford Plaza* (Md. 1950), 76 A. 2d 558, 561.

The intention of both Congress and the FHA is also gleaned from the fact that in neither the law nor the regulations was any downward revision of maximum rents contemplated if actual construction costs turned out to be less than estimated construction costs. *Dinkes* v. *Glen Oaks Village* (N. Y. 1954), 132 N. Y. S. 2d 138, 142. In those cases where the FHA relied upon rights which it claimed, it specifically and definitively issued a regulation to protect them. *Miller* v. *Walters* (N. Y. 1942), 34 N. Y. S. 2d 341. So in this case, the amendments to Sections 803, 903 and

908 (the successor to 608) requiring windfall profits to be paid on the mortgage was the declaration of a new purpose of Congress and a new purpose of the FHA and not the explanation of an old one.

Further evidence of Congressional understanding of the windfall situation was given by the passage of the "Collapsible Corporation Act" on September 23, 1950 (64 Stat. 934, Internal Revenue Code § 117(m), 26 U. S. C. A. (I. R. C. 1939) § 117(m)). Congress did not consider such distributions illegal but, it is now claimed by the Commissioner of Internal Revenue, sought to tax them as ordinary income instead of as capital gains. Up to this time, the Courts have construed such distributions to be capital gains and have implied or at least have not attacked their legality. *Commissioner* v. *Gross* (C. A. 2nd Cir.), Decided August 29, 1956; *Wilson* v. *Commissioner* (1956), 25 T. C. No. 120; *Weaver* v. *Commissioner* (1956), 25 T. C. No. 121.

The action of the Courts below in reading an intent into Acts of Congress, in spite of the Record and of the principles of law involved, is in conflict with the above cited decisions of this Court.

III

The Rule of Law Requiring That An Ambiguous Provision of a Contract Be Construed Against the Draftsman Should Not Be Reversed Because the Draftsman Is a Federal Agency.

III(a)

The general law is well established. The Court of Appeals has ruled that the distributions in question were prohibited by Article IV(b) of the charter, not because IV(b) in itself was restrictive but because

> "in view of the strict limitation provided throughout the charter as to the handling of the financial affairs

> of the corporation, it is not reasonable to construe the quoted language other than as a limitation upon the payment of dividends from any source other than net earnings." (*Infra* 5A).

These other restrictions the Court erroneously construed to have been designed solely to protect the contingent financial liability of FHA as insurer of the mortgages, but, in fact they are primarily intended to guarantee for FHA, during the period of insurance, proper maintenance of the project properties, the Replacement Reserve Fund and supervision of the rents and charges. The Court further said:

> "I think, also, that the distributions to the stockholders of the excess funds derived from the mortgage was a violation of Section V(a) of the charter quoted above. * * *."

thus, indicating its affirmation of the construction of this section of the charter by the District Court.

Do these charter provisions really say and mean what the Court of Appeals has held? Is there ambiguity as to the meaning of these sections?

It is enlightening to note what has happened during the course of these proceedings relative to the construction and interpretation of Articles IV(b) and V(a) of the corporate charters. While defaults under both sections were originally claimed by FHA, in its brief and argument, after the evidence was all in, FHA abandoned V(a) and relied exclusively on IV(b) as restricting dividends to net earnings. The District Court did not agree, but on the contrary ruled that V(a) restricted, without the consent of FHA, the disbursement or alienation of any corporate property, except those necessary for the operation of the project. The Court went on to say "clearly it does not outlaw dividends from net earnings, for that would conflict with an express

authorization within the same charter," obviously referring to IV(b) (Ap. pp. 169, 170). FHA did not appeal from the District Court's construction of IV(b), in the absence of which, it is questionable whether IV(b) is still in issue. *Partmar Corporation, et al.* v. *Paramount Picture Theaters Corporation, et al.*, 349 U. S. 89, 98 L. ed. 532, 74 S. Ct. 414.

Before the Court of Appeals Respondent again relied upon IV(b) of the charters, and insisted the District Court held the distributions to have been prohibited by IV(b). This contention, in the face of the plain language of the Opinion of the District Court, evidences the apparent disregard of the facts and the evidence by Respondent throughout these proceedings.

There is perhaps no more firmly established and universally accepted principle in law than that

> "where one party to a contract is privileged to set down in writing the terms to which another party is to give assent, and a controversy arises as to their meaning, the contract should be construed strictly against the writer and liberally toward the other party."

Grace v. *American Century Ins. Co.* (1883), 109 U. S. 278, 27 L. ed. 932;

E. I. DuPont de Nemours & Co. v. *Claiborne Reno Co.* (C. A. 8th Cir. 1933), 64 F. 2d 224; cert. den.;

Hoffman v. *Pfingsten* (Wis. 1951), 50 NW 2d 369;
Green v. *Royal Neighbors* (Kan. 1937), 73 P. 2d 1;
Pinnacle Packing Co. v. *Herbert* (Ore. 1937), 70 P. 2d 31;

Lyman-Richey Sand & Gravel Co. v. *State* (Neb. 1932), 243 NW 891.

The decisions of the lower courts are based upon unwarranted inferences and implications. If dividends were intended to be restricted as claimed the Act, the Rules and the Charters could have said "no dividends shall be paid on the common stock except out of net earnings from the operation of the project" and if FHA was intended to have complete domination over corporate disbursements, as claimed, restrictive language such as was used in 207 charters could have been employed. This was not done because it was not intended (Ex. 43b-Ap. p. 96a. 96b).

III(b)

FHA Model Charters Were Designed to Make Effective the Corporate Purposes, Powers and Restrictions Prescribed by the Administrative Rules. They Were Not Intended to Provide Other Additional Restrictions. The Rules Require That the Charters Make Effective the Restrictions Provided by the Rules.

The lower Courts have conceded that neither the National Housing Act nor the Rules of FHA prohibited the corporate distributions now complained of. The Court of Appeals said this in the following language:

> "A subsequent amendment of the statute provided that any excess of the proceeds of the insured mortgage loan over the cost of the property mortgaged should be applied in partial liquidation of the loan. While such application was not required by law at the time the loans here were obtained, there is nothing to prevent it; and that is manifestly what should have been done with the excess. In the absence of such a requirement, the FHA properly relies upon the provisions of the charter to prevent such distribution of corporate assets." (*Infra*, 9A).

This statement reveals the real basis for the Court's decision. The Court is imbued with the idea that the savings should have been applied on the loan. The Court is forced to admit that neither the Act nor the Rules require that

this be done. But in spite of this the Court countenances the attempt of the Federal Housing Administration to now read such restrictions into the corporate charters with full knowledge of the fact that FHA had widely advertised to prospective builders "Under Title VI as such there are no limits as to dividends or rate of return."

An analysis of FHA Rules and Model Charters under Section 207 with those prescribed under Section 608 clearly shows that the latter were merely greatly liberalized drafts of the former. The Rules for Section 207 rental housing projects in force at the time Section 608 was reactivated in 1946, had been revised in 1945 (Title 24 C. F. R. 532.1-532.24, 1945 Supplement). It will be recalled that the Commissioner was required under Section 207 to regulate mortgagors, among other things, as to rate of return. Such regulation was left to the discretion of the Commissioner under 608, and in the exercise of that discretion rate of return was not regulated or restricted. But, when regulation of rate of return was required, it was done by incorporating the restriction in the Rules (See 24 C. F. R. 532.17 b 1945 Supp. *infra*, 37A).

That the charter was intended as the means of making effective only the regulations and restrictions prescribed by the Rules is indicated by the following extracts from the Rules and the Commitment to Insure, to-wit:

> "Such regulation and the additional regulation and restriction provided in this Section shall be made effective by incorporation of appropriate provisions therefor in the charter or other instrument under which the mortgagor is created, or by agreement." (Paragraph 4, Section V Rules, Ex. 39, Ap. p. 92).

and,

> "The mortgagor must possess the powers necessary for and incidental to the purpose of providing housing

for rent and sale, and there shall be filed with the Commissioner prior to endorsement of the mortgage for insurance a regulatory agreement or a copy of the charter of the Mortgagor corporation or other authority certified to by the granting authorities as the case may require *in order to conform with the requirements of Section IV of the aforesaid Administrative Rules.*" (S-D Ex. 3 F., Ap. p. 159). (Italics added)

Are we to believe that after FHA established the Rules and gave them the force of law by their publication in the Federal Code of Regulations, the Model Charter was drafted not only to make effective the regulations and restrictions of the Rules, but also to conceal hidden traps to destroy the builders whose cooperation FHA so earnestly sought and solicited? The Model Charter was designed for the convenience of prospective mortgagors and more particularly for the convenience of FHA. One can readily imagine the difficulties involved in having hundreds of different attorneys representing hundreds of different projects each undertaking the drafting of separate corporate charters to provide for the corporate mortgagor the purposes, powers, regulations and restrictions prescribed by the Rules, and the endless task for the legal division of FHA in checking them for acceptability.

Is it conceivable that FHA would have approved Petitioners' By-Law 42 (Ap. p. 125) if it had been the intent of FHA to restrict dividends under 608 to net earnings? True the By-Law is subject to the provisions of the Certificate of Incorporation, but this clause merely gave recognition to a specific restriction of the charter that dividends should not be paid unless mortgage and replacement reserve requirements had been met (Ex. 49, Ap. p. 118).

By-Law 42 follows the language of the Virginia law with respect to the payment of dividends. Since all fixed charges

had been currently met, the distributions out of net assets in excess of capital were lawful and proper.

IV

The Axiom Inclusio Unius Est Exclusio Alterius Is Applicable Although a Federal Agency Is Involved.

The inclusion of certain enumerated controls in the 608 charters and in the rules relating thereto, by implication excluded other controls not enumerated, such as those claimed by the Commissioner in this case. The meaning of the exclusion of controls in 608 charters is emphasized by the specific inclusion in 207 charters of identical controls here claimed by the Commissioner.

The FHA prepared and drafted the model form of charter to be used under Section 608. The FHA also prepared and drafted the model form of charter to be used under Section 207. The contrasts between 207 and 608 charters prove beyond a reasonable doubt that the FHA did not intend to prohibit distribution under 608 charters, but did intend to prohibit distribution under 207 charters.

The contrasts are all the more important because of the District Court's reference to the restrictions by which he felt "the Commissioner reins" the directors and stockholders of the corporations (Ap. 167-169). And, because of the Appellate Court's enumeration of the restrictions contained in the corporate charters and its affirmance of the conclusion of the Trial Judge that the charters give the preferred stockholders "complete oversight" of the corporations, their real and personal property, revenues and disbursements (*infra*, 5A).

Undeniably, there are many restrictions on the borrower, all of them authorized by the Rules of the FHA, itemized in the 608 charters. However, the specification of one re-

striction by no means implies another restriction. As a matter of fact, *the specification of certain restrictions by implication denies the existence of other restrictions.*

> *United States* v. *Cooper Corporation* (1941), 312 U. S. 600, 85 L. ed. 1071.

In that case, involving the question whether the United States was a person under the Sherman Act, the Court said,

> "The connotation of a term in one portion of an Act may often be clarified by reference to its use in others. . . . The very fact, however, that this sweeping inclusion of various entities was thought important to preclude any narrow interpretation emphasizes the fact that if the United States was intended to be included Congress would have so provided expressly." (312 U. S. 606, 607, 85 L. ed. 1076).

The absence of intent to "rein" the directors against distribution of mortgage proceeds under 608 is amply proven by the following contrasts:

(1) The model form of 608 Charter, revised December, 1945, and in effect in 1949 when the Shirley-Dukes were incorporated, did not provide for regulation of rate of return (Ex. 42-D, Ap. 95). The model form of 608 Charter, revised February, 1952, did provide for regulation of rate of return (Ex. 42-E, Ap. 95).

(2) The model form of 207 Charter *in effect in 1949 when the Shirley-Dukes were incorporated* contained Article Eighth(a) which is identical with Article V(a) of the Shirley-Duke Charter (Ex. 43-B, Ap. 96a). Under the ruling of the Lower Courts, Article Eighth(a) would have been sufficient to prohibit distribution of net assets in excess of capital coming from mortgage proceeds. However, such was not the case. The FHA recognized it was not the case by inserting in the 207 Charters restrictive

provisions forbidding such distribution. The clauses are:

(3) Article Sixth(a) of the 207 Charters (being the 207 version of Article IV(b) of the 608 Charters) provides,

> "*No dividends, or distribution of income, shall be declared or paid except out of earned income . . . excluding from such computation of funds available for dividends or distribution any surplus created by revaluation of corporate assets* not approved in writing by the holders of the Preferred Stock". (Ex. 43-B, Ap. 96).

Article Sixth(a) in 207 is restrictive. Article IV(b) in 608 was permissive. Article Sixth(a) specifically forbids the payment of dividends from surplus created by revaluation of corporate assets. Article IV(b) contains no such prohibition. The omission of the prohibition in the 608 Charters proves that the FHA did not intend such prohibition.

(4) Article Third(a) of the 207 Charters regulates rate of return (43-B, Ap. 96a). There was no regulation of rate of return in the 608 Charters effective in 1950. Again, if the FHA had intended such regulation, it would have specified the regulation.

(5) Article Sixth(a) of the 207 Charters provided that one-half of earned income in excess of that required for regular dividends should be applied on the principal of the insured mortgage (Ex. 43-B, Ap. 96, 97). No such provision was included in the 608 Charters, and, therefore, the implication is that no such provision was intended.

(6) Article Tenth(3)(b)(1) of the 207 Charters limited the compensation payable to officers, directors, stockholders or employees (Ex. 43-B, Ap. 96b). No such limitation was contained in the 608 Charters.

The Lower Courts, in their decisions of this case, disregarded each and every one of the above contrasts. This

ignoring of the facts at best convicts the FHA and its attorneys of an abysmal inability to express themselves in the charter forms they drafted. Their omissions and defections must be construed against them. The inevitable consequence is summed up in one sentence in Fletcher's Cyclopedia on Corporations, Permanent Edition 1933, Section 9032:

> "If there are no such charter or statutory restrictions, dividends can be declared at any time out of surplus . . ."

The disregard of the Lower Courts of the axiom of *inclusio unius* and its application by the Court of Appeals (*infra*, 5A) constitutes decisions in conflict with the decisions of this Court in *United States* v. *Cooper Corporation* and many other Federal cases which have followed it.

V

The Shirley-Duke Corporations Are Subject to the Corporation Laws of Virginia. The Holding of Preferred Stock by the FHA Does Not Make the Corporations Instrumentalities of the Federal Government or Place Them Above the Law.

The laws of Virginia authorize the payment of corporate dividends out of net assets in excess of capital (Virginia Code of 1950, § 13.206, *infra*, 10A, 11A). The laws of Virginia spell out in these charters the right and the privilege of making the very distributions which were made in this case. Yet the Petitioners are compelled to argue that the courts below nullified these laws by disregarding them and by not considering them as an additional reason for the validity of the distributions. The District Court interpreted Article V(a) of the charters most restrictively against the common stockholders and based on this interpretation he then interpreted Article IV(b) most restrictively against the common stockholders. As a result of his

interpretation of IV(b) he then disregarded the Virginia laws (Ap. 172). The Court of Appeals side-stepped the application of the law. Instead of recognizing that the law permitted dividends from net assets in excess of capital, the Court took the negative approach and stated that there was nothing in the Virginia law to invalidate a limitation on the payment of dividends from net earnings (*infra*, 6A). Thus again the courts interpreted the charters and the applicable law most liberally in behalf of the very party which drew the charters and most strictly against the parties for whom they were drawn.

As a result of these interpretations and of the resulting disregard of State laws, the lower courts erroneously elevated the Shirley-Duke Corporations to a preferred position above the State law.

The result of the elevation of the Shirley-Duke Corporations above the reach of the State law is a most extreme application of the doctrine of Federalism. It amounts to a declaration that a business corporation, created under the laws of the State of Virginia, is not subject to the law of its creator, if its preferred stock is held by another corporation, which other corporation in turn is a profit making agency of the Federal Government. The Shirley-Duke Corporations are not Federal Corporations. They are Virginia Corporations. And they are twice removed from the United States Government. The Government itself does not own their preferred stock. A Government agency, itself comparable to a corporation, owns that stock.

This far reaching extension of the doctrine of Federal supremacy overrides and nullifies State law not only insofar as the Federal Government is concerned, not only insofar as a corporate agency of the Federal Government is concerned, but also in behalf of a private corporation

created under the laws of the State, in which private corporation the corporate agency of the Federal Government owns the preferred stock. Such a rule is inequitable in operation, undesirable in principle and unsupported in law.

When a sovereign descends from the heights of government into the valley of commerce and business, it sheds its sovereign immunities and enters the maze of procedural and substantive law like a private citizen. This rule applies particularly to the government as stockholder in a private corporation, and *a fortiori* to a government corporation as stockholder in a private corporation.

The controlling principles in such cases were formed in our law a century and a quarter ago by Chief Justice Marshall. In *Bank of the United States* v. *Planters' Bank of Georgia* (1824), 9 Wheat. 904, 6 L. ed. 244, he stated:

> "The State does not, by becoming a corporator, identify itself with the corporation. The Planters' Bank of Georgia is not the State of Georgia, although the State holds an interest in it.
>
> "It is, we think, a sound principle, that when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted. . . . It acts merely as a corporator, and *exercises no other power in the management of the affairs of the corporation than are expressly given by the incorporating act*". (Italics supplied).
>
> "The Government of the Union held shares in the old Bank of the United States; but the privileges of the Government were not imparted by that circum-

> stance to the Bank . . . the Government, by becoming a corporator lays down its sovereignty, so far as respects the transaction of the corporation, and exercises no power or privilege which is not derived from the charter." (9 Wheat. 907, 908, 6 L. ed. 244, 245).

These principles have been reaffirmed, deepened and broadened by modern decisions. The sovereign's "privileged position" has been "appropriately confined", and the government has not been allowed to become "the conduit of its immunity" for "its agents or instrumentalities merely because they do its work". "In spawning these corporations during the past two decades, Congress has uniformly included amenability to law . . . Such a firm practice . . . reveals a definite attitude on the part of Congress which should be given hospitable scope". *Keifer & Keifer* v. *Reconstruction Finance Corporation* (1939), 306 U. S. 381, 388, 390, 391, 83 L. ed. 784, 788, 789, 790.

Immunity, even for the sovereign itself, "is a legal doctrine which has not been favored by the test of time", "has increasingly been found to be in conflict with the growing subjection of governmental action to the moral judgment", and "public opinion as to the peculiar rights and preferences due to the sovereign has changed". *National City Bank* v. *Republic of China* (1955), 348 U. S. 356, 359, 99 L. ed. 389, 396.

As the sovereign itself, when acting in a commercial capacity, loses some of the attributes of sovereignty, so much the more does a corporation whose stock is owned in whole or in part by the sovereign. Stock ownership does not identify the corporation with its stockholder or confer upon the corporation the privileges and immunities of its stockholder. Rather stock ownership divests the sovereign of its superiority over law for the purposes of the corpora-

tion's business, and clothes it in the garb of the ordinary citizen. A corporation is like an ordinary man, "an instrumentality of government he might be, and for the greatest ends; but the agent, because he is agent, does not cease to be answerable for his acts". "The United States took all the stock but that did not affect the legal position of the company". *Sloan Shipyards Corp.* v. *United States Shipping Board Emergency Fleet Corp.* (1922), 258 U. S., 549, 566, 567, 66 L. ed. 762, 767, 768. *Keifer & Keifer* v. *Reconstruction Finance Corporation, supra, Bank of the United States* v. *Planters' Bank of Georgia, supra.*

The general rule has been followed in Virginia for a hundred years. As was said in *James River And Kanawha Co.* v. *Early* (1856), 13 Gratt. (54 Va.) 541, at pages 552 and 553:

> ". . . a corporation will be liable for damages specially occasioned to an individual by a breach or neglect of its corporate duties. . . . That the state owned a large interest in the stock of the company will not vary the case . . .". "It is not a public corporation representing the public, but it is a joint stock company which has undertaken the construction of a work useful to the public certainly but intended for the private emolument of the stockholders in dividends of the profits".

The last quotation applies to the FHA today. For the FHA is, to most intents and purposes, a federal corporation, subject to suit and to judgment for interest and costs. *Seven Oaks* v. *Federal Housing Administration,* (C. A. 4th Cir. 1948) 171 F. 2d 947, 12 U. S. C. A. 1702, 1743. And it is a corporation designed and run for profit. It charges an annual insurance premium of ½ of 1% on the average outstanding principal obligation of the insured mortgage for each succeeding year (Ex. 39, pp. 13-15). On June 30,

1953, its cumulative net income under Title VI amounted to $123,598,655.*

The FHA is subject to garnishment for moneys due its employees, without causing "grave interference with the performance of a governmental function". *Federal Housing Administration* v. *Burr* (1940), 309 U. S. 242, 84 L. ed. 724. Real property owned by the FHA is subject to municipal taxation and to the lien of the tax. The FHA Commissioner is subject to proceedings to enforce payment of the tax, even though the tax is levied subsequent to the recording of a mortgage held by the FHA. *Byram Holding Co.* v. *Bogren* (N. J. 1949), 63 A. 2d 822, *Sheridanville, Inc.* v. *Borough of Wrightstown* (D. C. N. J. 1954), 125 F. Supp. 743. Indeed the FHA as a mortgage holder is not preferred to an ordinary citizen, and mortgages acquired by it are subordinate to prior mortgages of private parties. *Riordan* v. *Ferguson* (C. A. 2nd Cir. 1945), 147 F. 2d 983, affirming (D. C. N. Y. 1941), 42 F. Supp. 47.* Negotiable paper of the FHA is subject to the ordinary law merchant, including the applicable negotiable instruments laws of the states. *United States* v. *Hansett* (C. A. 2nd Cir. 1941), 120 F. 2d 121.

---

* The risks on loans insured under Title VI are liabilities of the War Housing Insurance Fund established by amendment to the National Housing Act on March 28, 1941. The Fund was originally allocated $5,000,000 by the federal government to get it under way. In accordance with public law approved June 30, 1953, the $5,000,000 was established as a liability and subsequently was repaid to the government. The cumulative net income of the War Housing Insurance Funds, from its establishment March 28, 1941, to June 30, 1953, after adjustment of reserves, was $123,598,655 (Ex. 34, pp. 177, 178, 190).

* As the District Judge stated in his opinion, at page 50, "The United States did not acquire the within property for use in a governmental function, but rather acquired it as part of its business in administering the National Housing Act".

The above decisions are supported by a legion of other cases which tear the mask of sovereignty from agencies of the United States Government especially while they are engaged in business and commercial competition. As far back as *Fletcher* v. *Peck* (1810), 6 Cranch (U. S.) 87, 3 L. ed. 162, the Supreme Court held a sovereign state could not impair the obligations of its contracts. The same Court has modernized the doctrine in *United States Shipping Board Merchant Fleet Corporation* v. *Harwood* (1930), 281 U. S. 519, 74 L. ed. 1011, in *Keifer & Keifer* v. *Reconstruction Finance Corporation* (1939), 306 U. S. 381, 83 L. ed. 784, and in *Federal Land Bank* v. *Priddy* (1935), 295 U. S. 229, 79 L. ed. 1408. A sharp restriction on the privileges and immunities of agencies of the sovereign will result from *Indian Towing Company* v. *United States* (1955), 350 U. S. 64, 100 L. ed. 83. (Federal Tort Claims Act).

In the *Priddy* case, *supra*, the Court allowed the plaintiff to attach land owned by the Federal Land Bank, which (like the FHA) possessed some of the characteristics of private business corporations, such as the rights to contract, to receive interest and fees, to acquire and dispose of property, including land, and to make a profit (again like the FHA).

Under a long existing modern trend, private corporations with stock owned by the United States have been so completely subjected to state law that states have been permitted to invoke the writ of *quo warranto* against National Banks, even where charter violations are involved, if the charter violations are also violations of the laws of the states. *Missouri ex rel. Barrett* v. *First National Bank of St. Louis* (Mo. 1923), 249 S. W. 619, 30 A. L. R. 918, affirmed 263 U. S. 640, 68 L. ed. 486. In permitting the State of Missouri to prevent operation of a branch of a National Bank, the Court held that a *subsequent grant by*

law of a specific power negatived the claim that the specific power existed by implication before the grant, and said:

> "National Banks are subject to the laws of the state, and are governed in their daily course of business far more by the laws of the state than of the nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law . . . of course, in the broadest sense any limitation by a state on the making of contracts is a restraint upon the power of a National Bank within the state to make such contracts . . .
>
> "In this state the banking business can be conducted only by a corporation. Thus organized, the extent of its powers must, as we have said, be determined by the statute of its creation" (249 S. W. 624, 30 A. L. R. 925).

Again, the Petitioners remind this Court that the Shirley-Duke Corporations are twice removed from the United States Government, and that their charters, like those of other private corporations, are subject to the laws of Virginia. They were not chartered under the laws of the United States but under the laws of Virginia. They were not chartered by the United States or by the FHA, but by private incorporators. According to the rules of the cases contained in this portion of Petitioners' argument, even the FHA would be subject to the laws of Virginia if its own dividend distributions were involved. *A fortiori,* private corporations in which the FHA owns the preferred stock are subject to the corporation laws of this State. And under the laws of this State they have not only made a valid profit but have paid a valid dividend.

The failure of the courts below to declare the Virginia law applicable to this case and to apply the Virginia law

so as to validate the distribution which was made constitute a decision in conflict with the numerous cases cited above and decided by this Court and other Federal Courts.

VI

The FHA, Engaged as It Is in the Proprietary Function of Insuring Loans, Is Subject to the Laws of Estoppel and Contemporaneous Interpretation.

The doctrine of estoppel would seem to be available against the FHA while acting in its proprietary and contractual capacity in this case. *Fletcher* v. *Peck* (1810), 6 Cranch (U. S. 87, 3 L. ed. 162; *Branson* v. *Wirth* (17 Wall.), (U. S.) 32, 21 L. ed. 566; *United States* v. *Wood* (C. A. 4th Cir. 1938), 99 F. 2d 80, 82, 83 (summarizing the general and Virginial rules); *The Falcon* (D. C. Md. 1927), 19 F. 2d 1009; *Reconstruction Finance Corporation* v. *Sun Lumber Co.* (C. A. 4th Cir. 1942), 126 F. 2d 731.

In any event, under the doctrine of contemporaneous interpretation, the FHA should be enjoined from its attempt to oust the Shirley-Duke directors. Time and time again throughout the history of this case the FHA indicated clearly its knowledge and acceptance of the right of the Petitioners to earn the savings which were made in this case and to distribute them as dividends. Such knowledge and acceptance establish the conclusive presumption that it was the purpose and intent of FHA to permit such distributions.

It is a general rule of universal acceptance and long-standing that the contemporaneous construction placed on an ambiguous statute by the executive department charged with its administration or enforcement is given great weight in construing the statute especially if such construction has been uniform and consistent and has been observed and acted on and acquiesced in for a period of time. 82

C. J. S. 761, Statutes, § 359. Annotation 84 L. ed. 30. *Great Northern Railway Co.* v. *United States* (1942), 315 U. S. 262, 275, 86 L. ed. 836, 843; *Bailey* v. *Holland* (C. A. 4th Cir. 1942), 126 F. 2d 317, 323; *Seaboard Finance Corp.* v. *Commonwealth* (1946), 185 Va. 280, 287; *Keifer & Keifer* v. *Reconstruction Finance Corporation* (1939), 306 U. S. 381, 389, 83 L. ed. 784, 789.

As the Court stated in the *Bailey* case:

> "Administrative practice has peculiar weight when it involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion; of making the parts work efficiently and smoothly while they are yet untried and new." (p. 323).

And again, as the Virginia Supreme Court of Appeals stated the rule in the *Seaboard Finance Corp.* case:

> "So, also, the practical construction given to a statute by public officials, and acted upon by the people, is not only to be considered, but, in cases of doubt will be regarded as decisive. It is allowed the same effect as a course of judicial decision." (p. 287).

In the instant case the FHA time and again interpreted the law, rules and documents as allowing windfall distributions:

In 1946 and 1947, in "Rental Housing for Veterans", the FHA emphasized there would be no limitation on "dividends or rate of return" (Ap. 21). In its Rules the FHA refrained from regulating the rate of return (Ap. 90, 92-94).

In 1948, the FHA directed positively and expressly that the excess mortgage proceeds, the proceeds over and above the actual costs of the projects, be paid to the mortgagors (Ap. 155). The FHA prescribed a system of accounting

which revealed the actual costs of the projects, but which nevertheless permitted and provided for distribution from capital surplus (Def. Ex. 6, pp. 2, 3, 16).

By the time of the Senate hearings in the summer of 1949, the FHA recognized that windfall profits were being made, that builders were "mortgaging out", that they were building for actual costs which were less than estimated costs, that efficient builders were making greater savings than typical builders and were pocketing the proceeds (Ex. 24, Ap. 30-78, *supra*, 13-16). Indeed, in 1949 the FHA expressly approved the payment of dividends from windfall profits by at least one other 608 corporation (Ex. 46, Ap. 107-111).

The FHA Rules required that all mortgage proceeds be paid to the mortgagors (Ap. 88, 89), and implied that the mortgagors could encumber and dispose of unmortgaged properties (Ap. 89). The FHA Commitments inferred that the mortgagors might own and dispose of properties other than the mortgaged properties (Ap. 131), after having guaranteed payment to the mortgagors of the full amounts of the loans regardless of actual costs (Ap. 126, 127, 132, 133). The Building Loan Agreements and the mortgages also guaranteed payment to the mortgagors of the entire total amounts of the mortgage loans (Ap. 147, 151-A-N).

Moreover, throughout construction the FHA reserved the right to inspect the projects and to approve *every single advancement*, including the final advancement, made by the mortgagee to the mortgagors (Ap. 132, 133, 151-A-N). If the FHA had authority to "rein" the borrowers, it could have controlled them by withholding any illegal, unauthorized or undeserved payments. Failure to "rein"

is evidence that the right to "rein" did not exist in the mind and intention of the FHA.

In 1949, when the Shirley-Duke Corporations applied for loans and incorporated under 608 charters, the FHA knew how to prohibit dividends from windfall profits, and in fact did prohibit such dividends under 207 charters in clear, cogent clauses. The FHA could have inserted identical language in the Shirley-Duke charters if it had intended to prevent these dividends. The failure of the FHA to prohibit is evidence of intent not to prohibit.

For and after the year 1951 the Shirley-Duke Corporations reflected the distribution in financial reports filed with the FHA (S. D. Exs. 23a-f, 26, 27). The FHA received its share of the dividends (S. D. Exs. 23a-f). In 1956 the FHA reverted to its practice and purposes of 1950 by permitting the redrafting of charters in accordance with State laws so as to allow payment of dividends from surplus cash or other net assets in excess of capital (*supra*, 36). It is incredible that the FHA was not aware of the warnings, hearings and debates in Congress on the subject of windfall profits (*supra*, 8-21), or of the Treasury Regulations promulgated first in October of 1952 seeking to tax windfall profits, *permitted under state law*, as ordinary income, or of letters such as that from the Internal Revenue Service to counsel for the Shirley-Duke Corporations in November of 1950 (Ap. 112, 113). It is fair to say that in December of 1950 at the time of the distributions by the Shirley-Duke Corporations, this distribution was not considered unlawful by any Federal agency, including Congress, the FHA, the Department of Justice or the Internal Revenue Service.

The principle of contemporaneous administrative interpretation was applied to the FHA in the case of *Ferguson*

v. *Union National Bank of Clarksburg, W. Va.* (C. A. 4th Cir. 1942), 126 F. 2d 753, where a loan insured by the FHA was involved. In violation of its regulations, no profit and loss statement of the principal debtor was filed with the FHA but the FHA made no objection to the loan and continued to list it as insured. When sued for payment the FHA raised the defense of violation of its regulations. This Honorable Court cut down that defense in the following language.

> "The action of the defendant, in continuing to list the loan as insured after receiving notice that no profit and loss statement had been furnished, amounted to an *administrative interpretation of the regulation* that, under the circumstances disclosed, no profit and loss statement was necessary." (p. 757).

Later on in the same decision the Court determined that "evidence that the FHA had approved the plaintiff's claim in the amount sued for, subject to the approval of the Comptroller General, was admissible solely for the purpose of showing *administrative interpretation* of the regulations". (p. 758).

In the instant case the FHA should be enjoined against disavowal of its own continuous manifold interpretations of the laws, the rules, the contracts and the charters under which the parties acted in good faith. Otherwise, never in the field of business conflict will so many have been misled so much by so few.

The refusal of the courts below to apply the rule of contemporaneous interpretation to the acts and doings of the FHA create a conflict with the decisions of this Court and other Federal Courts which are cited above.

CONCLUSION.

The importance of the issue of Federal law involved in this case is stupendous and has ramifications which affect American citizens in nearly every part of the land. As of May 3, 1954, the FHA had insured a total of 7,069 projects under section 608 with mortgages totalling $3,448,433,228. As of the same time the Internal Revenue Service estimated that 1149 corporations had distributed to their share holders funds derived from the excess of mortgage proceeds over the actual cost of the projects. In other words, windfall profits had been earned and distributed by 1149 corporations (*infra*, 34A).*

A most graphic description of the mortal effect on business of the FHA's attempt to reverse its interpretations of its own contract and of the decisions of the Courts below in this very case is illustrated hereinafter (*infra*, 34A-36A).

---

* At approximately this same time the FHA had been called upon to make good on its insurance contract in only 67 cases and of these 67, 29 projects had been resold by the FHA for an aggregate profit of $188,535 over and above the mortgages involved (*infra*, 34A). The cumulative net income of the War Housing Insurance Fund through June 30, 1953, after adjustment of reserves, was $123,598,655 (Ex. 34, pp. 177, 178, 190).

Because of the importance of the case, because of the conflict between the decisions of the Courts below and decisions of this and other Federal Courts, this case should be reviewed by the Supreme Court and the judgments of the Courts below should be reversed.

Respectfully submitted,

BOOTHE, DUDLEY, KOONTZ & BOOTHE,

By: Armistead L. Boothe

ARMISTEAD L. BOOTHE

505 King Street,

Alexandria, Virginia.

Carl Budwesky

CARL BUDWESKY,

4613 Duke Street,

Alexandria, Virginia,

Counsel for Petitioners.

Alexandria, Virginia.
March 20, 1957.

INDEX TO APPENDIX

	PAGE
Opinion of United States Court of Appeals for the Fourth Circuit	1 A
Virginia Code of 1950, § 13-206	10A
Virginia Code of 1950, § 13.1-43	11A
Shirley-Duke Ex. 6A, Deed of Trust	12A
Exhibit 44A, Regulatory Agreement	25A
Excerpts from Hearings of April, 1954	35A
Excerpts from article in "Architectural Forum"	35A
Excerpts from Administrative Rules of the FHA Relative to § 207	37A
26 U. S. C. (I. R. C. 1939), § 115(c)	38A
26 U. S. C. (I. R. C. 1939), § 115(d)	38A

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

OPINION OF

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Decided January 7, 1957

* * *

PARKER, CHIEF JUDGE:

These are appeals from decrees denying injunctions in two cases heard together in the court below and argued together here. The appellants, whom we shall refer to hereafter as plaintiffs, are Virginia corporations which had constructed apartment houses with the proceeds of loans guaranteed by the Federal Housing Administration, hereafter referred to as F. H. A. The cost of construction of these apartment houses was less than the proceeds of the loans and the corporations had distributed the excess received from the loans among their stockholders under the guise of dividends. The F. H. A., which had guaranteed the payment of the loans, held preferred stock of the plaintiffs giving it the right to remove the boards of directors and elect new boards for their control upon violation by them of charter provisions. Contending that the payment of these "dividends" was such violation, it was proceeding to exercise its right to remove the old boards and elect new boards of directors to assume control of plaintiffs for the purpose of suing to recover the "dividends" when these suits were instituted to enjoin such action on its part. From the entry of decrees denying injunctions on the ground that the F. H. A. was proceeding in accordance with its rights under the corporate charter and the law applicable in the premises, the plaintiffs have appealed.

There is no dispute as to the facts upon which the District Judge acted in denying the injunctions. The common stockholders of the plaintiffs had made no more than a token investment in their stock and the preferred stock issued to the F. H. A. was insignificant in amount and was

issued for the sole purpose of giving the F. H. A. the right to police corporate activities for the protection of its rights as guarantor of loans.*1 The apartments were built entirely with funds obtained by plaintiffs on loans guaranteed by the F. H. A. Although these loans were supposed to be limited to 90% of cost and were limited to 90% of "estimated cost", (12 USCA 1701, 1743) they were in fact largely in excess of actual cost, so that a large sum remained which plaintiffs proceeded to distribute as "dividends" to common stockholders whose investment was insignificant in comparison with the amount thus paid to them out of the proceeds of the loans.*2 The pertinent facts were thus correctly and succinctly stated by the trial judge:

> "To encourage the erection of low cost rental housing the Congress of the United States authorized the Federal Housing Administration to insure repayment of loans made for that purpose up to 90% of the estimated cost of the projects. Under this law the Beverley Manor corporations and the Shirley-Duke corporations obtained loans, on their notes secured by mortgages on the properties and insured by the Administration, in the sum of $8,826,400 and $13,746,000 respectively. The actual cost of the completed project of Beverley Manor was $762,654.53 less than its insured loan, and of the Shirley-Duke $1,878,937.16 below its insured loan. However, the full proceeds of the

*1 In the case of the Beverley Manor corporations the investment of common stockholders was only $4,000, the investment of the preferred stockholder, F. H. A., was $400 of preferred stock, whereas the amount of the loan which was insured by F. H. A. and from the proceeds of which the apartments were constructed, was $8,826,400. In the case of the Beverley Manor Apartments, the common stock was $6,000, the preferred $600, and the amount of the insured loan was $13,746,000.

*2 Upon stock in which one stockholder in Shirley-Duke Apartments had invested $90, he received exceeding $62,000 in this "dividend". The total of the proceeds of the insured mortgage loan thus distributed to common stockholders by the Shirley-Duke corporations was $1,878,937.16, although the investment of these stockholders in the corporations was only $6,000.

loans had been received by the corporations, and soon after the completion of the projects the corporations disbursed these remaining moneys—the difference between the actual cost of the projects and the insured loans—to its stockholders as dividends. These differences were made apparently available for dividends by carrying the moneys into 'surplus', on the corporation's balance sheet, though a write-up, on a reappraisal, of the valuation at which the projects were entered. The Federal Housing Commissioner, being of the opinion that the corporate charters prohibited the payment of dividends out of any funds or assets except earnings, formally declared the instant appropriations violations of the charters. The court concurs—the insured moneys were not available for dividends.

"As a part of the insurance plan the Commissioner had acquired at a nominal price all of the preferred stock of each corporation. Each charter provided that any violation of its terms should be considered a default on the part of the corporation; and upon any such default the charter empowered the Commissioner, as the sole preferred stockholder, to remove the board of directors and elect a new set of his choice. On receipt of notice of his intention to invoke this sanction, the corporations brought these suits to enjoin his proposed action."

The District Judge denied the injunction on the ground that the F. H. A. was acting within its rights under the corporate charter, the pertinent provisions of which are as follows:

"Article IV. * * * (b) The net earnings of the corporation, after providing therefrom dividends on First Preferred Stock and on the Second Preferred Stock as hereinabove provided, and all reserves hereinafter required, may be applied each year in payment of dividends to the holders of Common Stock or may be applied or used in the redemption of the Second Pre-

ferred Stock as hereinafter provided. (No second preferred stock was ever issued.)

* * *

"Article V. The Corporation shall not without prior approval of the holders of a majority of the shares of First Preferred Stock, given either in writing or by vote at a meeting of the First Preferred Stockholders called for that purpose (a) assign, transfer, dispose of or encumber any real or personal property, including rents, except as specifically permitted by the terms of them ortgage or deed of trust, * * *".

We are in accord with the holding of the District Judge for reasons adequately stated by him in his memorandum; and little need be added to what is there said. The charter provisions above quoted are but two of numerous provisions designed to give the F. H. A. control over building corporations whose operations were to be conducted for the profit of common stockholders but at the risk of F. H. A., which guaranteed the payment of loans from which the real invested capital of the corporations was derived. The corporate charters, the form of which was prescribed by F. H. A., limited strictly what might and what might not be done by the corporations so long as the insured loans remained unpaid. They were forbidden to engage in any business other than the building and renting of the apartment buildings for which the loans were obtained. They were forbidden to retire the preferred stock held by the F. H. A. No dividends were to be paid, except with the consent of a majority of each class of shares, until all amortization payments under the mortgage had been paid and a reserve fund created. In case of liquidation, all debts of the corporations were to be first paid, including the insured mortgage, and the net assets were then to be applied to the payment of the first and second preferred stock before any distribution could be made to the common stock. The corporations might not, without the approval of F. H. A. as holder of the first preferred stock, dispose of or incumber any real or personal property, except as specifically permitted by the insured mortgage, or "remodel, reconstruct, demolish or

subtract from the premises", or charge rents in excess of schedule, or require as a condition of occupancy of any unit in the project the purchase of stock, or consolidate or merge with any other corporation, go into voluntary liquidation or carry into effect a plan of reorganization, or effect any change in capital stock. As said by the District Judge:

> "This charter gives the preferred stockholder, for the period of the insurance, complete oversight of the corporation, its real and personal property, its revenues, and its disbursements. Under its terms the only corporation funds or property distributable or alienable, except for operating costs, without the approval of the preferred stockholder are net earnings."

Among the limitations upon the powers of the corporations is the restriction of section IV(b), quoted above, providing that net earnings may be applied in the payment of dividends. The general rule is that dividends may be paid only from net earnings. 13 Am. Jur. p. 650; *et seq.*; *Mobile & Ohio R. Co.* v. *Tennessee*, 153 U. S. 486, 496-497. In some states, however, payment of dividends is permitted from net assets in excess of capital, and for this reason it was probably thought wise to designate in the charter the source from which dividends might be paid. At all events, in view of the strict limitation provided throughout the charter as to the handling of the financial affairs of the corporation, it is not reasonable to construe the quoted language other than as a limitation upon the payment of dividends from any source other than net earnings. The maxim "expressio unius est exclusio alterius" is clearly applicable. Where the charter provides explicitly that, in case of liquidation, the net assets shall be applied to the payment of the mortgage before anything can be paid on stock, it would be absurd to permit net assets to be siphoned off to stockholders in a partial liquidation under the guise of dividends, and particularly is this true where the net assets thus transferred to stockholders constitute mere borrowed capital for which the insured mortgage has been executed.

It is said that the law of Virginia, under which the corporations were chartered, permits the payment of dividends from assets other than net earnings;*1 but there is nothing in the law of Virginia which invalidates the limitation on dividends which the parties themselves have placed in the charter of the corporation and which, as we have seen, limit dividends to net earnings.*2 The same may be said of the by-law of the corporations relied on by appellants, in addition to the fact that it is expressly made subject to the limitations of the charter.*3

---

*1 The Virginia statute relied on is carried forward as 13-206 of the Virginia Code of 1956 and is as follows:

"Sec. 13-206. Capital defined; dividends; liability of directors for declaration of dividends.—The Board of directors of every corporation shall, unless otherwise provided in its charter, certificate of incorporation or articles of association, or in any amendment thereto, have power to declare any pay dividends upon the shares of its capital stock out of its net earnings, or out of its net assets in excess of its capital as hereinafter defined. The capital of a corporation shall be the sum of the consideration received by the corporation in payment for its shares of stock, whether with or without nominal or par value, plus such amounts as from time to time by resolution of the board of directors may be transferred to capital and/or less such amounts as may be transferred from capital by a reduction thereof, * * *".

*2 Even if the Virginia statute were applicable, a grave question would arise as to whether dividends might properly be paid from capital borrowed for an express purpose, as were the funds here. The mortgage recites: "That the funds to be advanced herein are to be used in the construction of certain improvements on the lands herein described".

*3 The provision of the by-laws relied on is as follows:

"Dividends. 42. *Subject to the provisions of the Certificate of Incorporation,* the directors may declare and pay dividends on the shares of the capital stock of the corporation out of the net earnings or out of its net assets in excess of its capital as defined by section 3840 of the Code of Virginia, at such times and in such amounts as the Board of Directors may from time to time designate. No dividend shall be paid in whole or in part from contributed surplus, upon any shares of stock without par value without written notice being given to stockholders receiving the same, at the time of payment of any such dividend." (Italics supplied).

In view of what has just been said, we deem it unnecessary to discuss whether, in the absence of the charter limitation, it would be proper to pay dividends from capital assets upon a reappraisement of corporate property such as was had here. It may properly be observed, however, that in application of sound accounting principles dividends may ordinarily be declared only out of actual earnings or profits and not upon a theoretical estimate of an unrealized appreciation in value of assets. See *Berk's Broadcasting Co.* v. *Cranmer*, 356 Pa. 620, 52 Atl. 2d 571; *Kingston* v. *Home Life Ins. Co. of America*, 11 Del. Ch. 258, 101 Atl. 898; *La Belle Iron Works* v. *United States*, 256 U. S. 377, 393, 394. *Cf. Randall* v. *Bailey*, 23 N. Y. S. 2d 173, 262 App. Div. 844, 288 N. Y. 280, 43 N. E. 2d 43. And see *United States* v. *Riely*, 169 F. 2d 542, 544, 4 Cir.

We think, also, that the distribution to the stockholders of the excess funds derived from the mortgage was a violation of section V(a) of the charter quoted above, which forbids the corporation, without the prior approval of the preferred stockholders, to "assign, transfer, dispose of or encumber any real or personal property, including rents, except as specifically permitted by the terms of the mortgage or deed of trust." It is argued that the quoted provision applies only to mortgaged property, but no such limitation is contained in the language and it is not reasonable that it be implied in view of the purpose to protect the F. H. A. as insurer of the loan. The transfer or incumbrance of property of the corporation, even though not covered by the mortgage, might well result in loss to the F. H. A. as insurer and would certainly defeat to a great extent the control it was supposed to have over the financial affairs of the corporation. Appellants profess to find comfort in the excepting clause in the language quoted; but we see no comfort for them there. That clause merely excepts from the general prohibition transfers provided for in the mortgage, such as the right reserved in the Beverley Manor mortgage to deed and dedicate to the City of Columbus certain ways and easements for street purposes. The charter was a model form prescribed by F. H. A. for general use, and this exception was evidently phrased in gen-

eral terms to cover situations where transfer of property would be necessary and foreseen at the time of the execution of the mortgage, although not foreseen at the time the form was drafted. In such cases provision for transfer in the mortgage would release the property from the limitation of the charter as well as the mortgage lien.

To distribute among the common stockholders funds of the corporation which had been borrowed for the express purpose of building the apartments, was clearly to deplete the assets available for the payment of the insured loan in manifest violation of this charter provision inserted for the protection of the insurer. It is no answer to say that such protection is not accorded in the case of loans to individual mortgagors; for, in the case of insured loans to individuals, the F. H. A. protects itself by an appropriate agreement directed to that form of transaction. Furthermore, funds received by an individual increase his net worth and thus add to his ability to repay the loan. Funds received by a corporation have this effect only so long as they remain the property of the corporation.

Appellants contend that the legislative history of section 608 of the National Housing Act, 12 USC 1743, the section under which the loans here were insured, contemplated, the insuring of loans and the receipt by mortgagors of proceeds thereof in excess of the value of the property mortgaged as security. We do not so read the history of that section. It is true that at the time of various amendments to and extensions of the Housing Act, there was discussion of the fact that insured loans were in some cases obtained in excess of the value of the property mortgaged; but this was recognized as an abuse which was to be guarded against, not a practice which was to be encouraged. It is true also that there was discussion of the fact that actual cost might be reduced below estimated cost by savings resulting from elimination of some items of the estimates, such as architects and builders' fees; but there is absolutely nothing that we have seen in the congressional history to which our attention has been called, or elsewhere, which evidences an intention on the part of Congress that any part of the proceeds of insured loans might be

distributed among the stockholders of borrowing corporations. A subsequent amendment of the statute provided that any excess of the proceeds of the insured loan over the cost of the property mortgaged should be applied in partial liquidation of the loan. While such application was not required by law at the time the loans here were obtained, there was nothing to prevent it; and this is manifestly what should have been done with the excess. In the absence of such requirements, the F. H. A. properly relies upon the provisions of the charter to prevent such distribution of corporate assets and, where such distribution has been had, properly takes steps to recover the funds that have been improperly distributed. If recovered, they can be paid on the loans in partial liquidation or can be held and invested by the corporations. The insured loans have many years to run, years in which no one can foresee the course of prices and values. The possession by the mortgagor corporations of these assets will add to the protection of the risks assumed by the F. H. A. in the insuring of the loans from whcih the assets were derived.

It is argued that the F. H. A. is estopped to insist upon its rights under the charters because it has countenanced the distribution of proceeds of mortgages as dividends in other cases * and because it has received from plaintiffs dividends on the preferred stock held by it. There is no merit in this contention. An agency of the government is not estopped from insisting on rights under one contract because it has failed to insist on rights under others. So far as the dividends on preferred stock are concerned, these amounted to five cents per share on the preferred stock, or $20 from the four Beverley Manor corporations and $30 from the six Shirley-Duke corporations, and might well be disregarded under the *de minimis* principle. The finding of fact of the District Judge with respect to the matter, which is not attacked here so far as its factual basis is concerned, is as follows:

---

* With respect to this, the argument is made that while this may not strictly be an estoppel it is binding upon the F. H. A. as a "contemporaneous interpretation" of the charter provisions.

"The evidence does not establish an estoppel to preclude the Commissioner from moving against the corporations. His request of them for, and his receipt from them of, an annual dividend of $5.00 each upon his preferred stock does not constitute a concurrence in the dividend distribution. A preponderance of the evidence does not prove that he was then acting with full knowledge of the source of the dividend. If a dividend had been declared, he was required to collect the amount due on the preferred stock. In doing so he cannot be presumed to have upheld the legality of the distribution."

In addition, we agree with the District Judge that the principles of estoppel cannot be invoked to preclude action in the public interest by an officer or agency of the government. *Federal Ins. Corp.* v. *Merrill,* 332 U. S. 380, 384; *United States* v. *Stewart,* 311 U. S. 60, 70; *Utah Power & Light Co.* v. *United States,* 243 U. S. 389, 409.

Affirmed.

Virginia Code of 1950:

"§ 13-206. Capital defined; dividends; liability of directors for declaration of dividends.—The board of directors of every corporation shall, unless otherwise provided in its charter, certificate of incorporation or articles of association, or in any amendment thereto, have power to declare and pay dividends upon the shares of its capital stock out of its net earnings, or out of its net assets in excess of its capital as hereinafter defined. The capital of a corporation shall be the sum of the consideration received by the corporation in payment for its shares of stock, whether with or without nominal or par value, plus such amounts as from time to time by resolution of the board of directors may be transferred to capital and/or less such amounts as may be transferred from capital by a reduction thereof, pursuant to the provisions of chapter

7 of this title, and shall not include contributed surplus when, under the terms and conditions of the subscription agreement to any shares of stock, it is provided that in addition to the consideration paid for such stock, there shall be paid by the subscriber a sum to be contributed surplus of the corporation. No dividend shall be paid, in whole or in part, from contributed surplus upon any shares of stock without written notice being given to stockholders receiving the same, at the time of payment of any such dividend.

If the board of directors declare, and pay a dividend out of any part of the capital, as hereinbefore defined, all members of the board who shall be present, and know that such dividend is declared in violation of this section, and shall not dissent therefrom, shall, in their individual capacity, be jointly and severally liable to the corporation's creditors for the amount of such dividend so unlawfully paid and may be proceeded against therefor on a bill in equity filed on behalf of such creditors and, moreover, each stockholder who participates in such dividend shall be liable to such creditors to the extent of such dividend unlawfully paid so received by him." (Code 1919, § 3840; 1932, p. 132).

Virginia Code of 1950:

"§ 13.1-43. Dividends.—The board of directors of a corporation may, from time to time, declare and the corporation may pay dividends on its shares in cash, property or its own shares, except when the corporation is insolvent or when the payment thereof would render the corporation insolvent or when the declaration or payment thereof would be contrary to any restrictions contained in the articles of incorporation, subject to the following provisions:

(a) Dividends in cash or property may be declared and paid, except as otherwise provided in this section, only out of the unreserved and unrestricted earned surplus of the corporation or out of capital surplus, howsoever arising, but each dividend paid out of the capi-

tal surplus shall be identified as a distribution of capital surplus and the amount per share paid from such surplus shall be disclosed to the stockholders receiving the same concurrently with the distribution." *

SHIRLEY-DUKE EXHIBIT 6A

DEED OF TRUST

THIS DEED OF TRUST, made and entered into this 27th day of July in the year 1950, by and between Shirley-Duke Apartments, Section I, Incorporated, a corporation organized and existing under laws of Virginia, party of the first part, and E. M. Bros and Carl Budwesky, Trustees, hereinafter called the "Trustees", parties of the second part.

WITNESSETH, that for and in consideration of One Dollar ($1) cash in hand paid, the receipt whereof is hereby acknowledged, the said party of the first part does grant and convey with General Waranty unto the said party of the second part the following property in the _____ of _____ County of Fairfax, and Commonwealth of Virginia, to wit:

All of Section 1A and Section 1B of the Subdivision of "Shirley-Duke Apartments," as shown on the plat thereof duly dedicated, platted and recorded among the land records of Fairfax County, Virginia, in Deed Book 717 at page 539, TOGETHER with and SUBJECT to rights and provisions of agreement relating to incinerator recorded in Liber 760, Page 314, Fairfax County, Virginia Land Records.

---

* This section is a part of the revision of the corporation laws of Virginia passed by the General Assembly in 1956. The revisor's comment on the above section is as follows:

"This Section is an important codification of sound practice in a field where there is now no statutory provision. The section differs from the Model Act so as to preserve the present Virginia privilege for payment of dividends from contributed or capital surplus. It differs from present Virginia law by forbidding the payment of dividends from current earnings while capital is impaired, thus overruling *U. S.* v. *Rielly*, 169 F. 2d 542 (1948)."

The party of the first part covenants and agrees that so long as this deed of trust and the said note secured hereby are insured under the provisions of the National Housing Act, it will not execute or file for record any instrument which imposes a restriction upon the sale or occupancy of the mortgaged property on the basis of race, color or creed. Upon any violation of this undertaking, the holder of the note may, at its option declare the unpaid balance of the debt secured hereby immediately due and payable.

TOGETHER with the privileges and appurtenances to the same belonging, and all of the rents, issues, and profits which may arise or be had therefrom; and

TOGETHER with all buildings and improvements of every kind and description now or hereafter erected or placed thereon, and all fixtures, including but not limited to all gas and electric fixtures, engines and machinery, radiators, heaters, furnaces, heating equipment, steam and hot water boilers, stoves, ranges, elevators and motors, bathtubs, sinks, water closets, basins, pipes, faucets and other plumbing and heating equipment, and all cabinets, mantels, refrigerating plant and refrigerators, whether mechanical or otherwise, cooking apparatus and appurtenances, and all furniture, shades, awnings, screens, Venetian blinds and other furnishings; and

TOGETHER with all building materials and equipment located on the premises and intended to be incorporated in the buildings or other improvements; and

TOGETHER with all articles of personal property now or hereafter attached to or used in and about the building or buildings now erected or hereafter to be erected on the lands herein described which are necessary to the complete and comfortable use and occupancy of such building or buildings for the purposes for which they were or are to be erected including all goods and chattels and personal property as are ever used or furnished in operating a building or the activities conducted therein, similar to the one herein described and referred to, and all renewals or replacements thereof or articles in substitution therefor, whether or not

the same are, or shall be attached to said building or buildings in any manner. All of the foregoing shall be deemed to be, remain and form part of the realty and are covered under this Deed of Trust.

In Trust to secure to Investors Diversified Services, Inc., a corporation organized and existing under the laws of Minnesota or its assigns, the payment of a certain promissory note bearing even date herewith, made by party of the first part, in the principal sum of Two Million Six Hundred Seventy-four Thousand Dollars ($2,674,000), with interest from date at the rate of four per centum (4%) per annum on the unpaid balance until paid, and payable to the order of Investors Diversified Services, Inc., at its office in Minneapolis, Minnesota, or at such other place as the holder may designate in writing, the said principal and interest being payable in monthly installments as follows:

> Interest alone payable monthly on the first day of August, 1950; and on the first day of each month thereafter to and including December 1st, 1950. Thereafter commencing on the first day of January, 1951, installments of interest and principal shall be paid in the sum of Twelve thousand two hundred fifty-five and 84/100 Dollars ($12,255.84) each, such payments to continue monthly thereafter on the first day of each succeeding month until the entire indebtedness has been paid. In any event the balance of principal (if any) remaining unpaid, plus accrued interest, shall be due and payable on July 1st, 1983. The installments of interest and principal shall be applied first to interest at the rate of four per centum (4%) upon the principal sum or so much thereof as shall from time to time remain unpaid, and the balance thereof shall be applied on account of principal.

And Also in Further Trust to secure payment of any note or notes given in renewal or extension of the aforesaid note, and to secure payment of any additional sum or sums which may be due or become due from the party of the first part to the Trustee(s) or the holder of the said note, or its or their successors and assigns, under the pro-

visions hereof or under the provisions of a certain Building Loan Agreement hereinafter mentioned; and also to secure the performance on the part of the party of the first part of each and every covenant, condition, and agreement contained herein or in said Building Loan Agreement hereinafter mentioned.

Also Upon the Further Trust that the said party of the first part shall remain in quiet and peaceable possession of the above-granted and described premises, and take the profits thereof to its own use, until default be made in the payment of any matter of indebtedness hereby secured or in the performance of any of the covenants herein provided; and also to secure the reimbursement to the holder of said note and to the party hereto of the second part, or substitute Trustee, or Trustees, and any purchaser or purchasers under any sale or sales as provided by this Trust, for any and all costs and expenses incurred in respect thereto, including reasonable counsel fees incurred or paid on account of any litigation at law or in equity which may arise in respect to this Trust, or to the indebtedness on the property heretofore mentioned, or in obtaining possession of the premises after any sale which may be made as hereinafter provided for.

Upon the full payment of said note, and the interest thereon, and all moneys advanced or expended, as herein provided, and all other proper costs, charges, commissions, half-commissions, and expenses, the party of the second part shall release and reconvey the above-described premises unto and at the cost of party of the first part.

In the event that default shall be made in the payment of the said note or of any monthly installment of principal and interest as therein provided for, or in the payment of any of the monthly sums for ground rents, taxes, special assessments, water rates, mortgage insurance, fire and other hazard insurance, all as hereinafter provided, or upon default in payment on demand of any money advanced by the holder of said note on account of any proper cost, charge, commission, or expense in and about the same, or on account of any tax or assessment or insurance, or expense of

litigation, with interest thereon at four per cent (4%) per annum from date of such advance (it being hereby agreed that on default in the payment of any tax or assessment or insurance premium or any payment on account thereof, or in the payment of any said costs, expense of litigation, as aforesaid, the holder of the note may pay the same and all sums so advanced, with interest as aforesaid, shall immediately attach as a lien hereunder, and be payable on demand) or upon failure or inability faithfully and fully to keep and perform any of the other conditions or covenants herein provided; then upon any and every such default so made as aforesaid it is expressly covenanted and agreed by said party of the first part that the holder of the note hereby secured may, at its option, treat the whole principal debt as immediately due and payable, and shall in order to recover said principal debt or sum and interest thereon and other payments provided for herein, have the right then or thereafter at any time to sue thereon at law or in equity, or to enforce payment thereof by means of any remedies or provisions in these presents contained or as may be provided by law; and these rights shall exist notwithstanding that by the terms of said note it may not on its face be due.

In the event of default occurring as described in the preceding paragraph, then the Trustee, his successor, or any substitute Trustee, on being requested so to do by the holder of the note, shall sell for cash the property hereby conveyed after first advertising the time, terms, and place of sale for five times in some newspaper published in, or having a general circulation in, the county or city wherein the property lies, or by any other legal method of advertisement that the Trustees may deem wise, which cash shall be distributed by the Trustee in the following manner, to wit:

So much of the proceeds as may be necessary to defray the expense of executing this Trust, including a Trustee's commission of Two per centum (2%) on the gross proceeds of sale hereunder, and all proper costs, charges, and expenses, including all attorneys' and other fees, and costs herein provided for, and all moneys advanced for costs or expenses, or expense of litigation as aforesaid, or ground

rents, or taxes or assessments or insurance, with interest thereon as aforesaid, and all taxes, general and special, water rates, and assessments, due upon said land and premises at the time of sale, and to discharge the amount of money then payable upon the said note according to its tenor; together with all interest accrued and to accrue thereon up to the date of payment of the purchase money by the purchaser at such sale. And the Trustee or Trustees shall pay the remainder of said proceeds, if any, to the party of the first part, upon delivery of and surrender to the purchaser of possession of the premises as aforesaid, sold and conveyed, less the expense, if any, of obtaining possession. At any sale hereunder the Trustee, or any substitute Trustee, shall have authority at his discretion to require any bidder to deposit prior to receiving his bid or to knocking down the property to him, a bidder's deposit of not more than $25,000.00 before his bid is received, which shall be refunded to the bidder unless the property is sold to him, otherwise to be applied to his credit in settlement, or should he fail to complete his purchase promptly, to be applied to pay the costs and expenses of sale, and the balance, if any, to be retained by the Trustee, or the substitute, as his compensation in connection with the sale.

In case of death of the said Trustee, his or its successor or successors or his or its refusal or inability for any reason to make said sale or to perform said trust, then the holder of said note shall have the right and is hereby irrevocably authorized and empowered to appoint, successively, in writing, a suitable person residing in the Commonwealth of Virginia, his or its successor who shall become the Trustee, herein, as the substitute for said Trustee named herein, and said substitute Trustee shall thereupon succeed to all the estates, rights, powers, and trusts hereinbefore granted to or vested in the said named Trustee.

Privilege is reserved to pay the debt in whole or in an amount equal to one or more monthly payments on principal next due, on the first day of any month prior to maturity upon at least thirty (30) days prior written notice to the holder. If this debt is paid in full prior to maturity and while insured under the National Housing Act, all

parties liable for payment thereof hereby agree to be jointly and severally bound to pay to the holder hereof the adjusted premium charge referred to in Section 2, Article III, of the applicable Regulations for Section 608; provided that such adjusted premium charge shall not exceed the aggregate amount of premium charges which would have been payable if the note and this Deed of Trust securing same had continued to be insured until maturity and shall be subject to all exceptions contained in said Regulation.

The exercise of the privilege to prepay as herein granted is subject to payment to the holder of the note of a prepayment charge on the amount of the principal prepaid in any one calendar year which is in excess of fifteen per centum (15%) of the original amount of the indebtedness, as follows: During ten years from date, four per centum (4%) of such excess; thereafter, one per centum (1%) of such excess.

And the said party of the first part, in order more fully to protect the security of this Deed of Trust, does hereby covenant and agree as follows:

That it will promptly pay the principal of and interest on the indebtedness evidenced by the said note, at the times and in the manner therein provided.

That, concurrently with, and in addition to, the monthly payments of principal and interest payable under the terms of the note secured hereby, party of the first part will pay to the holder of the note, monthly, on the first day of each month after the date hereof until the note is fully paid, the following sums:

(*a*) If and so long as said note of even date and this Deed of Trust are insured under the provisions of the National Housing Act, an amount sufficient to accumulate in the hands of the holder of the note one month prior to its due date the annual mortgage insurance premium, in order to provide the holder of the note with funds to pay such premium to the Federal Housing Commissioner pursuant to Section 608 of the National Housing Act, as amended, and Regulations thereunder.

(*b*) A sum equal to the ground rents, if any, next due, plus the premiums that will next become due and payable on policies of fire and other hazard insurance covering the mortgaged property, plus water rates, taxes, and assessments next due on the mortgaged property (all as estimated by the holder of the note) less all sums already paid therefor divided by the number of months to elapse before one month prior to the date when such ground rents, premiums, water rates, taxes, and assessments will become delinquent, such sums to be held by the holder of the note in trust to pay said ground rents, premiums, water rates, taxes, and special assessments.

(*c*) All payments mentioned in the two preceding subsections of this paragraph and all payments to be made under the note secured hereby shall be added together, and the aggregate amount thereof shall be paid by the party of the first part each month in a single payment to be applied by the holder of said note to the following items in the order set forth:

(I) premium charges under the contract of insurance with the Federal Housing Commissioner;

(II) ground rents, taxes, special assessments, water rates, fire and other hazard insurance premiums;

(III) interest on the note secured hereby; and

(IV) amortization of the principal of said note.

Any deficiency in the amount of such aggregate monthly payment shall, unless made good by the party of the first part prior to the due date of the next such payment, constitute an event of default under this Deed of Trust.

Any excess funds accumulated under (*b*) of the next preceding paragraph remaining after payment of the items therein mentioned, shall be credited to subsequent monthly payments of the same nature required thereunder; but if any such item shall exceed the estimate therefor the party

of the first part shall without demand forthwith make good the deficiency. Failure to do so before the due date of such item shall be a default hereunder. In case of termination of the Contract of Mortgage Insurance by prepayment of the note and deed of trust in full, or otherwise (except as hereinafter provided), accumulations under (*a*) of the next preceding paragraph hereof not required to meet payments due under the Contract of Mortgage Insurance, shall be credited to the party of the first part. If the property is sold under foreclosure or is otherwise acquired by the holder of the note after default, any remaining balance of the accumulations under (*b*) of the next preceding paragraph shall be credited to the principal of the debt secured hereby as of the date of commencement of foreclosure proceedings or as of the date the property is otherwise acquired; and accumulations under (*a*) thereof shall be likewise credited unless required to pay sums due the Commissioner under the Contract of Mortgage Insurance.

That it will pay all ground rents, taxes, assessments, water rates, and other governmental or municipal charges, fines, impositions, for which provision has not been made by payments as hereinbefore provided and in default thereof the holder of the note secured hereby may pay the same; and that it will promptly deliver the official receipts therefor to the said holder.

That the party of the first part will keep improvements now existing or hereafter erected on the mortgaged property insured against loss by fire and such other hazards, casualties, and contingencies, as may be stipulated by the Commissioner upon the insurance of the mortgage and other hazards as may be required from time to time by the holder of the note, and all such insurance shall be carried in such companies and be for such periods as may be required by the holder of the note, and be in an amount which will comply with the co-insurance clause applicable to the location and character of the property but not less than eighty per centum (80%) of the actual cash value of the insurable improvements and equipment of the property. Such policies shall be in standard form and endorsed with

standard mortgagee clause with loss payable to the holder of the note and the Federal Housing Commissioner as interest may appear, and shall be deposited with the holder of the note. (Italics supplied, above and below.)

That if the premises covered hereby, or any part thereof, shall be damaged by fire or other hazard against which insurance is held as hereinbefore provided, the amounts paid by any insurance company pursuant to the contract of insurance shall, to the extent of the indebtedness then remaining unpaid, be paid to the holder of the note secured hereby, and, at its option, may be applied to the debt or released for the repairing or rebuilding of the premises.

That it will keep the mortgaged premises in good order and repair and will not commit or permit any waste of the said premises, reasonable wear and tear excepted.

That party of the first part will not assign the rent or any part of the rent of said premises nor demolish or remove any building without the written consent of the holder of the note. Pursuant to the laws of the Commonwealth of Virginia, in which said premises are situated, in event of default in the performance of any of the covenants or conditions hereof, the Trustee, either in person or by agent, shall be entitled to the immediate possession of said premises and to receive and collect the rents, issues, and profits thereof, and if the party of first part shall, after default and after demand for possession, remain in possession of said premises, the party of first part shall be tenant at will thereof of the Trustee, and shall at once surrender possession on demand to the Trustee, who may thereupon enter and take possession and collect the rents, issues, and profits of said premises and apply them, less five per centum (5%) thereof to be reserved as commission, in payment of the expenses incurred in obtaining possession and toward the repairs and insurance of said premises, and the payment of the taxes and assessments thereon and in redemption from sales therefor, and of the indebtedness secured hereby.

The Trustee may act hereunder and may sell and convey said premises under the powers granted by this instrument

although the Trustee has been, may now be, and may hereafter be attorney or agent of the holder of the note secured hereby or in respect to any matter or business whatsoever. The holder of said note may bid and become the purchaser at any sale under this Deed of Trust.

That party of the first part will not voluntarily create or permit to be created against the property subject to this Deed of Trust any lien or liens inferior or superior to the lien of this Deed of Trust and further that it will keep and maintain the same free from the claim of all persons supplying labor or materials which will enter into the construction of any and all buildings now being erected or to be erected on said premises, and on the failure of the party of the first part to perform these covenants, or any part thereof, thereupon the principal and all arrears of interest shall, at the option of the holder of said note or any holder of the note secured by this Deed of Trust, become due and payable, anything contained herein to the contrary notwithstanding. (Italics supplied.)

This Deed of Trust is made, executed, and delivered pursuant to and is to be construed in accordance with the provisions of Sections 5166 and 5167 of Michie's 1942 Code of Virginia. The note (or notes) hereby secured is identified by the Trustee's signature; exemptions are waived; is subject to call upon default and renewal or extension is permitted.

That the improvements about to be made upon the premises above described and all plans and specifications comply with all municipal ordinances and regulations made or promulgated by lawful authority, and that the same will upon completion comply with all such municipal ordinances and regulations and with the rules of the applicable Board of Fire Underwriters. In the event the party of the first part shall at any time fail to comply with such rules, regulations, and ordinances which are now or may hereafter become applicable to the premises above described, after due notice and demand by the holder of the note, thereupon the principal sum and all arrears of interest and other charges provided for herein, shall at the option of the holder of the note become due and payable.

That the funds to be advanced herein are to be used in the construction of certain improvements on the lands herein described, in accordance with a building loan agreement dated 19 , between the party of the first part and

,

which building loan agreement (except such part or parts thereof as may be inconsistent herewith) is incorporated herein by reference to the same extent and effect as if fully set forth and made a part of this Deed of Trust; and if the construction of the improvements to be made pursuant to said building loan agreement shall not be carried on with reasonable diligence, or shall be discontinued at any time for any reason other than strikes or lock-outs, the holder of the note secured hereby, after due notice to the party of the first part or any subsequent owner, is hereby vested with full and complete authority to enter upon the said premises, employ watchmen to protect such improvements from depredation or injury, and to preserve and protect the personal property therein, and to continue any and all outstanding contracts for the erection and completion of said building or buildings, to make and enter into any contracts and obligations wherever necessary either in its own name or in the name of the party of the first part, and to pay and discharge all debts, obligations, and liabilities incurred thereby. All such sums so advanced by the said holder of the note (exclusive of advances of the principal of the indebtedness secured hereby) shall be added to the principal of the indebtedness secured hereby and shall be secured by this Deed of Trust and shall be due and payable on demand with interest at the rate of four per centum (4%) per annum, but no such advances shall be insured unless same are specifically approved by the Federal Housing Commissioner prior to the making thereof. The principal sum and other charges provided for herein shall, at the option of the holder of this Deed of Trust and the note secured hereby, become due and payable on the failure of the party of the first part to keep and perform any of the covenants, conditions, and agreements of said building loan agreement. This covenant shall be terminated upon the making of the final advance as provided in said building loan agreement.

POOR COPY

Notice of the exercise of any option granted herein, or in the note secured hereby, to the holder thereof, is not required to be given.

The covenants herein contained shall bind, and the benefits and advantages shall inure to, the respective heirs, executors, administrators, successors, and assigns of the parties hereto and to the extent permitted by law shall bind any subsequent owner or owners of the mortgaged premises. Whenever used, the singular number shall include the plural, the plural the singular, and the use of any gender shall include all other genders.

IN WITNESS WHEREOF, the said Shirley-Duke Apartments, Section I, Incorporated, party of the first part, has caused this deed to be duly executed in its corporate name by Bryan Gordon, Jr., its president, and its corporate seal to be duly affixed and attested by Herman W. Hutman, its secretary, all of which has been done by due authority of its board of directors and ratified by its stockholders as of the day, month, and year first hereinabove written.

SHIRLEY-DUKE APARTMENTS, SECTION I,
INCORPORATED

By BRYAN GORDON, JR.
President

(SEAL)

[CORPORATE SEAL]

Attest:

HERMAN W. HUTMAN
Secretary

COMMONWEALTH OF VIRGINIA,

CITY OF ALEXANDRIA, to wit:

I, EDNA MAE ZIMMERMAN, a notary public in and for the Commonwealth and county aforesaid, do certify that Bryan

Gordon, Jr. and Herman W. Hutman, whose names as president and Secretary, respectively, of Shirley-Duke Apartments, Section 1, Incorporated, are signed to the foregoing deed bearing date on the 27th day of July, 1950, have each acknowledged the same before me in my county aforesaid.

Given under my hand this 27th day of July, 1950.

My commission expires May 19, 1952.

EDNA MAE ZIMMERMAN
Notary Public.

* * *

EXHIBIT 44A

REGULATORY AGREEMENT (2466A)

(For use in case of sale and assumption of liability after completion)

This Agreement, dated this day of , 19 , by and between , hereinafter referred to as Mortgagor, or party of the first part, and , as Federal Housing Commisioner under the provisions of the National Housing Act, as amended, hereinafter referred to as Commissioner, or party of the second part,

WITNESSETH:

WHEREAS, party of the first part has purchased from , hereinafter referred to as Seller, the title to the fee-leasehold to the premises and properties of that certain project designated and identified as FHA Project No. , also known as , located in , County of , and State of , and more specifically described as follows:

AND, WHEREAS, said property is encumbered by a mortgage in the original sum of $, in favor of , dated , 19 , and now appearing of record in Book ,

page , of the records of County, State of , to which record reference is made for the terms and conditions of said mortgage, and for a full and correct description of the property covered thereby and involved herein, which indebtedness is insured by the Federal Housing Commissioner pursuant to the provisions of the Section 608 of Title VI of the National Housing Act, as amended, and the applicable Rules and Regulations thereunder; and,

WHEREAS, Seller desires to be released, and the mortgagee named in said mortgage and party of the first part have requested the Commissioner to approve the release of Seller from liability under the provisions of said note and mortgage, and to substitute and recognize party of the first part as mortgagor and as bound and obligated under the terms of said note and mortgage, party of the first part having, by separate agreement, assumed all of said obligations; and,

WHEREAS, under the provisions of the National Housing Act, and the Administrative Rules, promulgated by the Commisioner in accordance with the directives of said Act, it is provided that the property upon which there is a mortgage insured by the Federal Housing Commissioner shall be held by a mortgagor approved by the Commissioner, and, further, that said mortgagor shall be regulated or restricted as to rentals or sales, charges, capital structure, and methods of operation to the extent that the Commissioner, in his discretion, shall require; and,

WHEREAS, the Commissioner is unwilling to approve the release of Seller as mortgagor and to approve the substitution of party of the first part as mortgagor and the recognition of said party of the first part as the party bound and obligated under the terms and conditions of said note and mortgage unless and until party of the first part shall, by entering into the covenants and agreements hereinafter set out, consent to be regulated and restricted by the Commissioner as provided in Section 608 of Title VI of the National Housing Act, as amended, and in the applicable Administrative Rules and Regulations thereunder; now,

THEREFORE, in consideration of the mutual promises, agreements and undertakings hereinafter contained, and the sum of One Dollar ($1.00) and other good and valuable considerations by each of the parties to the other in hand paid, receipt of which is hereby acknowledged, and in consideration of the approval of the release by the Commissioner of Seller from liability under the provisions of the note and mortgage herein referred to, and the substitution of party of the first part as mortgagor, and in order that the mortgagor may be regulated and restricted by the Commissioner as provided in said Section 608, and the applicable Administrative Rules and Regulations thereunder, the parties hereto do hereby agree as follows:

A. The Mortgagor agrees until such time as the Contract of Mortgage Insurance shall terminate without obligation upon the Commissioner to issue debentures as a result of such termination (and during such further period of time as the Commisioner shall be the owner or holder or reinsurer of the mortgage):

(1) To continue to maintain a reserve fund for replacements, in which fund there is now a balance of $, by the allocation to such reserve fund in a separate account with the Mortgagee or in a safe and responsible depository designated by the Mortgagee, concurrently with payments towards amortization of the principal of the Mortgage insured by the Commissioner (unless a later date is approved in writing by the Commissioner) of an amount equal to $ per month. Such fund, whether in the form of a cash deposit or invested in obligations of, or fully guaranteed as to principal and interest by, the United States of America shall at all times be under the control of the Mortgage. Disbursements from such fund, whether for the purpose of effecting replacements of structural elements, furnishings, and mechanical equipment of the project or for any other purpose, may be made only after receiving the consent in writing of the Commissioner.

(2) (a) That dwelling accommodations of the Mortgagor shall be rented at rents not exceeding a maximum average rental per room per month fixed by the Mortgagor and approved by the Commissioner. A schedule of rentals for the reasonable rental value of each apartment, based upon the average as so determined, shall be filed with the Commissioner, within ten days from the date of this agreement and, when approved by him, shall thereafter be maintained except as provided in paragraph (3) of this Section A. Dwelling accommodations of the Mortgagor shall not be rented for a period of less than thirty days or in excess of three years nor shall the property be rented as an entirety without prior written approval of the Commissioner. Garage, store, or other accommodations or facilities, shall be rented at a rental to be fixed by the Mortgagor with the prior written approval of the Commissioner.

(b) The Mortgagor shall have the right to charge to and receive from any tenant such amounts as from time to time may be mutually agreed upon between tenant and the Mortgagor, with the written approval of the Commissioner, for any facilities and/or services which may be furnished by the Mortgagor to such tenant upon his request, over and above the facilities and services to which such tenant may be entitled by virtue of his lease, including, among other things, telephone operator and switchboard services, electric current, gas, air cooling and conditioning, furniture or furnishings, and other additional or extraordinary facilities or services which may be furnished by the Mortgagor in connection with the operation of such housing facilities.

(3) The Mortgagor shall not (a) transfer, dispose of or encumber any of the real property encumbered by the insured mortgage herein referred to except to a person or persons or corporation satisfactory to and approved by the Commissioner,

and who shall, by legal and valid instrument in writing, to be recorded or filed in the same recording office in which conveyances of the property covered by the mortgage are required to be filed or recorded, duly assume all obligations under the insured note and mortgage herein, and under this agreement, it being agreed that this provision is to be deemed a covenant running with the land described herein, so long as the Commissioner is the owner, holder, insurer or reinsurer of any mortgage thereon; (b) assign, transfer, dispose of, or encumber any personal property, including rents, except as specifically permitted by the terms of the mortgage or with the prior written approval of the Commissioner; (c) remodel, reconstruct, demolish or subtract from the improvements or premises subject to the insured mortgage herein without the prior written approval of the Commissioner; (d) permit the occupancy of any of the dwelling accommodations of the Mortgagor except at or below the rents fixed by the schedule of rentals provided for herein; or (e) file any voluntary petition or other application for adjustment or relief in bankruptcy, or make any assignment for the benefit of creditors, or fail to establish and maintain the reserve fund for replacements provided for in this agreement.

(4) The Mortgagor shall maintain the mortgaged premises, accommodations and the grounds and equipment appurtenant thereto in good and substantial repair and condition: Provided, that, in the event all or any of the buildings covered by the Mortgage shall be destroyed or damaged by fire or other casualty, the money deriving from any insurance on the property shall be applied in accordance with the terms of the insured Mortgage on the premises.

(5) The mortgaged property, equipment, buildings, plans, offices, apparatus, devices, books, contracts, records, documents, and other papers relating

thereto shall be subject to examination and inspection at any reasonable time by the Commissioner or his duly authorized agents; the Mortgagor shall keep copies of all written contracts or other instruments which affect the mortgaged property, all or any of which may be subject to inspection and examination by the Commissioner or his duly authorized agents.

(6) The books and accounts of the operations of the mortgaged property shall be kept in accordance with the uniform system of accounting prescribed by the Commissioner.

(7) The Mortgagor shall furnish the Commissioner within 60 days following the end of each fiscal year an annual financial report satisfactory to the Commissioner of the operations of the mortgaged property.

(8) At the request of the Commissioner, his agents, employees, or attorneys, the Mortgagor shall give specific answers to questions upon which information is desired from time to time relative to the income, assets, liabilities, contracts, operation, and condition of the property and the status of the insured Mortgage and any other information with respect to the Mortgagor or the mortgaged property which may be requested.

B. The Mortgagor agrees to observe and perform each and every one of the covenants, conditions, and provisions required to be observed and performed under or pursuant to the terms of the Mortgage.

C. It is specifically agreed between the parties hereto that the breach of any of the terms of this Agreement by the Mortgagor will substantially damage and injure the Commissioner in the proper performance of his duties under the provisions of Section 608 of the Act, and will impede and injure the proper operations intended under such Act; that such damage will be irrespective of and in addition to any damage to the

security of the mortgaged premises or to any financial damage the Commissioner may suffer as insurer; that, except for the agreements herein contained, the Commissioner would not have issued, and would not have been authorized to issue, under the provisions of Section 608 of the Act, his Contract of Mortgage Insurance and that the Mortgagee would not have loaned the sum above mentioned on the security of the said Mortgage unless the same were insured by the Commissioner, and would not voluntarily continue such loan without the continuance of such insurance.

D. It is further specifically agreed that the amount of any damage ensuing by reason of a breach by the Mortgagor of any of the terms, conditions, or provisions of this Agreement will be difficult to ascertain and that the Commissioner shall, in addition to any other right or remedy which he may have hereunder, have the right to resort to injunction in any Federal or State Court to restrain a breach or threatened breach of this Agreement.

E. The parties hereto further agree as follows:

(1) Conditioned upon the happening of any event defined as "an event of default" in paragraph (2) of this Section E, all rents, issues, and profits of the premises included in the insured Mortgage are hereby from and after such default assigned and sold to the Federal Housing Commissioner, his successors in office or interest and assigns, for the following purposes:

(a) As further security for the payment of principal, interest, taxes, and assessments, hazard insurance premiums, mortgage insurance premiums, foreclosure costs, and other sums due or to become due under the insured Mortgage or any substitute mortgage, so long as said Mortgage or substitute mortgage shall continue to be insured under the provisions of the Act, or so long as said mortgage may be held or owned by the Commissioner;

(b) As security for the establishment and maintenance of the reserve fund for replacements provided for in paragraph (1) of Section A hereof; (c) To indemnify and save harmless the Federal Housing Commissioner, his successors in office or interest, and his assigns, from all loss or damage, court costs, legal and other expenses which may be suffered by reason of the happening of any event of default hereunder, as defined in paragraph (2) of this Section E.

(2) The following events are defined as "events of default" hereunder and are the events upon each of which the rents, issues, and profits mentioned in paragraph (1) of this Section E are assigned: (a) Breach of any agreement contained in Sections A, B, or E hereof;

(b) Any default under the insured Mortgage or any substitute insured mortgage:

(c) Breach of any agreement whereby the Project covered by the insured Mortgage, or any part of of said Project, is to be operated;

(d) Failure to have dismissed within 30 days of commencement of any receivership or bankruptcy proceeding or other proceeding for the liquidation or adjustment of the affairs of the Mortgagor or other owner of the property covered by the insured mortgage, or any substitute insured mortgage;

(e) Sale or lease of the mortgaged property or any interest therein except as provided in paragraph (2) (a) of Section A hereof without the written approval of the Commissioner.

(3) In case of the happening of any event of default, as defined in paragraph (2) of this Section E, and the continuation thereof for 15 days the Commissioner shall have the right forthwith to enter into and take possession of the mortgaged prem-

ises and the power to employ an agent or manager to act for and in the name of the mortgagor, and to manage and operate the mortgaged premises, to collect rents, make leases thereof, and to receipt for the same in the name of the Mortgagor or the Owner, as the case may be, which said agent or manager shall be paid from project income; and after deducting 5 percent of the gross amount of said rents, as the cost of collection thereof, to apply the remainder from time to time (a) to the cost of operating the property; (b) to the payment of taxes and assessments; (c) to payments required under the insured mortgage; (d) to apply so much of the balance as may be necessary to any of the purposes set forth in paragraph (1) of this Section E; and to pay over the balance, if any, to the owner of the premises or other person entitled thereto, or, in his discretion, to apply the same as a credit on the mortgage indebtedness.

(4) The assignment of rents herein shall be subject and subordinate to any assignment of rents contained in the insured Mortgage or any substitute insured mortgage, and the right hereby given to collect said rents and to apply the same as aforesaid shall continue and may be exercised by the Federal Housing Commissioner, his successors, or assigns, so long as any event of default, as defined in paragraph (2) of this Section E, shall continue and until the Federal Housing Commissioner has been indemnified, as provided in subparagraph (c) of paragraph (1) of this Section E, and the rights of the Commissioner, his successors and assigns, under the aforesaid assignment of rents, shall continue and may be exercised from time to time, as often as any default, as hereinbefore defined, shall occur, but shall cease in any event when the insured Mortgage or any substitute insured mortgage shall cease to be insured under the provisions of the Act.

The Commissioner is hereby irrevocably authorized to renegotiate or surrender or cancel any leases which may call for rents in excess of those consented to by the Commissioner and to refund or give credit to persons entitled thereto for any such excess rents; and in the name of the Mortgagor to give releases or acquittances therefor.

The Commissioner shall not be liable for any of his acts hereunder except for flagrant misfeasance.

The covenants and agreements herein set out shall be deemed to run with the land herein described and to bind any future purchaser of the real property or any part thereof.

The term "Mortgage" shall include "Deed of Trust"; Note shall include "Bond"; "Mortgagor" shall include "Grantor" under any Deed of Trust; and "Mortgagee" shall include the "Beneficiary" under Mortgage or Deed of Trust however designated. The use of the plural shall include the singular; the singular the plural; and the use of any gender shall be deemed to include all genders.

This instrument shall bind, and the benefits shall inure to, the respective parties hereto, their legal representatives, executors, administrators, successors in office or interest, and assigns.

The invalidity of any clause, part or provision of this agreement shall not affect the validity of the remaining portions thereof.

The Mortgagor agrees and assumes the obligation to have this agreement recorded in the appropriate land records in the jurisdiction in which the real property herein described is situated; and, in the event of failure so to do, it is agreed that the Commissioner may have the same recorded at the expense of the Mortgagor.

In Witness Whereof the parties hereto have duly executed this agreement the day and year first above written.

IMPORTANCE OF ISSUE OF FEDERAL LAW

Excerpts from Hearings Before the Committee On Banking and Currency, United States Senate, Eighty-third Congress, Second Session, on National Housing Act, April 1954: *

* * *

The Internal Revenue Service alleged to the Committee that 1149 corporations had "distributed to shareholders funds representing for the most part the excess of mortgage proceeds over actual cost of the project" (p. 1468). 1149 corporations got "windfall profits", meaning the difference between the actual cost and the amount of the mortgage (p. 1751).

Through December 31, 1953, the FHA had been called upon to make good on its insurance contract in only 67 projects. Of those 67, 29 projects had been resold by FHA at an aggregate profit of $188,535 over and above the mortgage amounts involved (p. 1476).

* * *

Excerpts from Article in November, 1956, Issue of "Architectural Forum" Entitled "Why Apartment Building Lags".

* * *

Apartment builders today look forward to living with FHA about as much as they relish a 30-year visit from a domineering in-law. They have learned that FHA's decision and agreements are subject to change and that it has a bulging briefcase of legal opinion to prove that its vacillation is justified.

A Lopsided Partnership. When a builder agrees to sponsor an FHA-insured apartment project, he enters into a partnership with FHA, the terms of which are set in the project's certificate of incorporation, a standard FHA form. This document gives FHA general authority over the proj-

---

* While the report of these hearings was not put in evidence at the trial of this case, it is believed that the Supreme Court of the United States, under its own decisions, may take judicial notice thereof. *Carolene Products Co.* v. *U. S.* (1944), 323 U. S. 18, 89 L. Ed. 15.

ect, including the right to set rents and to control replacement expenditures from reserves and the distribution of other corporate funds. And, *under the new Housing Act amendments, FHA will also keep a close watch on actual construction costs for the purpose of certifying costs and determining the mortgage limit.*

Even though its interests are amply protected by the security of the real property, FHA considers itself the senior member of the partnership with the right to treat the property almost as if it were the owner. As a result, the rights of stockholders in these apartment projects are subordinate to FHA's.

This lopsided relationship between FHA and the owner-builder does not merely reflect the attitude of the agency's present staff; it has become an integral part of the administration itself and has been reinforced by court interpretations of the law. FHA legally established its position as the senior partner in the courts during the recent Shirley Duke apartment ("windfall profit") case. . . . . .

* * *

A DOUBLE STANDARD. FHA is now going to the court for further extension of its rights—perhaps to the point that it will no longer be governed by ordinary law applicable to private individuals and business corporations. For example, FHA officials apparently do not consider themselves bound by previous FHA approvals or policies or by approvals they themselves may have previously issued. They claim the right to repudiate even written approvals and authorizations accepted in good faith by project builder-owners. They make claims against project owners without regard to the statute of limitations which bars such claims between individuals and between corporations.

In the so-called "608 enforcement program" *FHA is retroactively applying interpretations of regulations and procedures never contemplated at the time by FHA and the project sponsors.* In these 608 projects it retroactively refuses to recognize items of cost which it now recognizes as items of cost in present-day projects. (And the 608 mort-

gage was intended to be liberal financing to help meet the emergency housing shortage.) If today's cost rules governing Section 220 housing were applied to yesterday's Section 608 projects, a good many of FHA's present claims against the 608 sponsors probably would not stand up.

FHA's *double standard* is bad enough for a 608 owner, but is even worse for the sponsor of a new apartment project. It means that, even if he understands all the conditions of his contract, he must realize that the conditions may be changed at FHA's convenience or that FHA may apply against him the strictest interpretation of the rules.

A New Series of Loopholes. FHA has revised its model form of certificate of incorporation but, it still contains several one-way loopholes through which FHA may wriggle when and if it wants to.

* * *

Excerpt from Rules of FHA for Rental Housing Project Under Section 207 of the National Housing Act.

(Title 24, C. F. R. 532.1-532.24, 1945 Supplement)

532.17 (b) Rate of Return. Regular dividends or distribution of income may be declared and paid only as of the end of a semi-annual or annual fiscal period. Dividends or distribution of income may be declared and paid only from earned income legally available for dividends or distribution of income in excess of all operating expenses, taxes, assessments, fixed charges, mortgage insurance premiums, required allocations to the Fund for Replacements and payments permitted to be passed by reason of prepayments theretofore made. No regular dividend or distribution of income may be declared or paid for any fiscal year in excess of six per cent 6% per annum of the equity as valued by the Commissioner but may be cumulative from year to year and the dollar amount of such dividends or distribution of income shall be stated in the charter; Provided, that one-half of such earned income in excess of the regular dividends or distribution of income may be declared or paid as extra dividends or distribution of income for a

provision for dividends or distribution of income as provided herein and will also provide that in any event one-half of earned income in excess of regular dividends or distribution of income shall be applied annually in reduction of principal of the insured mortgage.

26 U. S. C. § 115

(c) Distributions in liquidation. Amounts distributed in complete liquidation of a corporation shall be treated as if full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. . . .

(d) Other distributions from capital. *If any distribution, made by a corporation to its shareholders* is not out of increase in value of property accrued before March 1, 1913, and *is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. This subsection shall not apply to a distribution in partial* or complete *liquidation* or to a distribution which, under subsection (f) (1), is not treated as a dividend, whether or not otherwise a dividend.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Questions presented	2
Statute involved	2
Statement	3
The corporate charters	3
The dividend distributions	5
The present proceedings	7
Argument	10
Conclusion	23
Appendix	24

CITATIONS

Cases:

Allen v. *Trust Co.*, 326 U.S. 630	23
Commissioner of Internal Revenue v. *Hirshon Trust Co.*, 213 F. 2d 523, certiorari denied, 348 U.S. 861	12
Comstock v. *Group of Investors*, 335 U.S. 211	23
Federal Crop Insurance Corp. v. *Merrill*, 32 U.S. 380	22
Pick Mfg. Co. v. *General Motors Corp.*, 299 U.S. 3	23
Sherman v. *United States*, 155 U.S. 673	22
United States v. *Dickinson*, 331 U.S. 745	23
United States v. *Summerlin*, 310 U.S. 414	22
Utah Power & Light Co. v. *United States*, 243 U.S. 389	22
Weinberg v. *Baltimore Brick Co.* (Del. 1955), 114 A. 2d 812	15

Statutes, rules and regulations:

National Housing Act, 48 Stat. 1246, as amended:	
Section 207	17, 20
Section 608	2, 5, 13, 14, 15, 17, 18, 20, 21, 24
Section 608(a)	24
Section 608(b)	4, 24
Section 908	17, 21
61 Stat. 945	18
62 Stat. 1269	18
24 C.F.R. (1949 ed.) 280.26	12, 13
24 C.F.R. (1949 ed.) 280.26c	13
24 C.F.R. (1949 ed.) 280.29	13
24 C.F.R. (1949 ed.) 280.1-280.41	12

Statutes, rules and regulations—Continued

Page

FHA Administrative Rules and Regulations (24 C.F.R. 280.19, 280.20):
Section III(11) 8
Section III(12) 8
Uniform System of Accounts promulgated by the FHA.. 15, 16
1410 16
1420 16
2140 16
3210 16–17
Virginia Code (1950), Section 13-206..... 11

Miscellaneous:

Dodd and Baker, *Cases and Materials on Corporations* (1951), p. 1086 12
8 Fletcher, *Cyclopedia of Corporations*, Section 4190.... 11
Hearings before the Senate Committee on Banking & Currency on S. 349, 82d Cong., 1st Sess.:
p. 153 21
pp. 516-517 21
p. 518 21
Hearings before the Senate Committee on Banking and Currency pursuant to S. Res. 229, 83rd Cong., 2d Sess. 20
Hearings before a Subcommittee of the Senate Committee on Banking & Currency on S. 2246, 81st Cong., 1st Sess., p. 458 20
Kehl, *Corporate Dividends*, pp. 28-81 14
S. Rep. No. 772, 80th Cong., 1st Sess..... 17

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 855

SHIRLEY-DUKE APARTMENTS, SECTION 1, INCORPORATED, ET AL., PETITIONERS

v.

NORMAN P. MASON, FEDERAL HOUSING COMMISSIONER, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the United States District Court for the Eastern District of Virginia (R. I 164-174) [1] is reported at 139 F. Supp. 207. The opinion of the United States Court of Appeals for the Fourth Circuit (Pet. App. 1A-10A) is reported at 240 F. 2d 428.

---

[1] The printed record here comprises three volumes. Volume I (R. I) consists of Appellants' Appendix in the court below; Volume II (R. II) consists of Appellees' Appendix below, and Volume III (R. III) contains the Court of Appeals proceedings.

JURISDICTION

The judgment of the Court of Appeals was entered on January 7, 1957 (R. III 18). The petition for a writ of certiorari was filed on March 25, 1957. The jurisdiction of this Court is presumably invoked under 28 U.S.C. 1254(1).[2]

QUESTIONS PRESENTED

The Shirley-Duke corporations are Virginia corporations, organized for the purpose of obtaining Federal Housing Administration insured loans to construct low rental apartment dwellings pursuant to Section 608 of the National Housing Act, as amended, 12 U.S.C. 1743. The amount of the insured loans, which was determined prior to construction on the basis of estimated costs, was substantially greater than the actual costs of construction, and the excess was paid out by the corporations to their common stockholders as dividends. The question presented is:

Whether both courts below were correct in holding that the payments by the corporations of dividends out of the excess FHA insured mortgage proceeds violated the corporate charters, so as to justify the exercise by the Commissioner of the Federal Housing Administration of his right under the charters to assume control of the corporations.

STATUTE INVOLVED

The relevant provisions of Section 608 of the National Housing Act, as amended, 12 U.S.C. 1743, in effect at the time herein involved, are set forth in the Appendix, *infra*, pp. 24-25.

---

[2] Petitioners also cite as jurisdictional bases 28 U.S.C. 2101; 12 U.S.C. 1702; 12 U.S.C. 1743 (Pet. 2).

STATEMENT

Petitioners, the six Shirley-Duke Apartment corporations and their officers, instituted three actions in the District Court seeking permanently to enjoin the Commissioner of the Federal Housing Administration, the owner of all of the corporation's preferred stock, from holding special meetings of the preferred stockholders (R. II 18a-31a). The purpose of these meetings was to remove the existing directors and to elect new directors because of, among other alleged charter violations, the corporations' distribution as dividends of the excess proceeds from their FHA-insured mortgage loans (R. II 25a-26a). Following trial, the District Court, ruling that the corporations' charters permitted dividends to be paid only out of net earnings, held that the corporations' distribution as dividends of the excess of the FHA-insured mortgage money violated their charters, and constituted grounds under the charters' Article VI(c) for the Commissioner's proposed actions (R. I 164-174).[3] On appeal, the Court of Appeals affirmed (Pet. App. 1A-10A). The relevant facts may be summarized as follows:

The Corporate Charters. The six Shirley-Duke corporations were organized on June 7, 1949, under the laws of the State of Virginia (R. II 57a). The purpose of the corporations "was to construct and operate rental housing facilities, and to cooperate in the obtaining of contracts of mortgage insurance from the Federal Housing Commissioner pursuant to the provisions of

[3] Since they involved virtually identical legal issues, the instant cases were consolidated for trial with *Loftus* v. *Mason* and disposed of in the same opinions by both the District Court and the Court of Appeals. Certiorari has not been sought, however, in the *Loftus* case.

Section 608 of the National Housing Act" (R. II 19a-20a.) In order to qualify for insurance under Section 608, the corporate charters followed the form prescribed by the Commissioner under his authority to regulate the mortgagor with respect to "rents or sales, charges, capital structure, rate of return, and methods of operation." Section 608(b)(1), *infra*, p. 24. Each charter provided, *inter alia* (R. I 116, 120):

> Article IV(b). The net earnings of the corporation, after providing therefrom dividends on First Preferred Stock and on the Second Preferred Stock as hereinabove provided, and all reserves hereinafter required, may be applied each year in payment of dividends to the holders of Common Stock or may be applied or used in the redemption of the Second Preferred Stock as hereinafter provided.
>
> * * * * *
>
> Article V. The Corporation shall not without prior approval of the holders of [a] majority of the shares of First Preferred Stock, given either in writing or by vote at a meeting of the First Preferred Stockholders called for that purpose (a) assign, transfer, dispose of or encumber any real or personal property, including rents, except as specifically permitted by the terms of the mortgage or deed of trust * * *.

The charters further provided in Article VI that control of each corporation was vested in the common stockholders, with the proviso that upon the occurrence of any of certain specified defaults by a corporation the holders of the first preferred stock may call a meeting

for the purpose of replacing existing directors until the defaults are cured (R. I 119, 122). Among such defaults is a breach of a charter provision (R. I 121).

The Dividend Distributions. Early in 1949, officials of Investors' Diversified Services, Inc., conceived the idea of constructing and operating an apartment development (which ultimately became the Shirley-Duke Apartments) with FHA insured mortgage loans under Section 608. I.D.S. originally offered to Bryan Gordon, Jr., Earl J. Preston, and Herman Hutman, who were experienced builders—and the builders accepted—a 50% interest in the development if they would, without any cash investment, take charge of the construction work (Tr. 636-637). Subsequently, however, I.D.S. apparently decided not to participate in the ownership of the development and, consequently, new arrangements were made whereby Gordon, Preston, and Hutman were to have a 100% interest in the project, and I.D.S. was, subject to certain conditions, to advance the money needed during construction for which I.D.S. was to receive 6½% of the FHA insured mortgage loan. (Tr. 634-640; 683-687, 767).[4] Under these arrangements, FHA permanent mortgage insurance would be effective only when the project was completed. In accordance with these arrangements, Gordon, Preston, and Hutman, as sponsors of the proposed corporations, and I.D.S., as prospective mortgagee, applied in March 1949 to FHA for commitments to insure the permanent mortgage loans under Section 608 (S.D. Ex. 2).

---

[4] This amount which totalled about $900,000 was ultimately paid out of the proceeds from the permanent mortgage (Tr. 639-640; 683-700).

As already stated, *supra,* p. 3, the six Shirley-Duke corporations were organized on June 7, 1949. Each of the corporations issued 200 shares of no-par common stock, which was sold at $5 a share to Gordon, Preston, Hutman and persons associated with them (R. II 59a-60a). The $1,000 thus paid for the common stock of each corporation constituted the stockholders' entire financial investment (Tr. 703). In addition, in accordance with FHA's rules and regulations, as well as their charters, each corporation issued 100 shares of first preferred stock to FHA at one dollar a share (R. II 59a).

In the meantime, beginning in early June and extending into July, FHA issued its commitments to insure permanent loans upon completion of the development in a total amount of $13,746,000, representing 90% of its estimated necessary cost (R. I 155-163, 164). Agreements to borrow that amount were thereupon consummated between the corporations and I.D.S., and, in July 1949, the construction of the project was begun (R. II 20a). Upon completion of the project in 1950, FHA fulfilled its commitments by insuring the mortgages held by I.D.S. (R. II 20a-21a). Under the mortgages, the corporations were obligated to repay the money borrowed, with interest, over a period of 391 months (32 years, 7 months) ending in 1983, and in the event of a default the FHA was bound by its contract of insurance to pay the amounts remaining due and unpaid (R. II 37a).

Although $13,746,000 was borrowed by the corporations and insured by the FHA as representing ninety percent of the estimated necessary costs of the project, the actual cost of the completed project, including all

of the fees to the mortgagee, was less than $12,000,000 (R. I 164). Shortly after completion of the project, the corporations had their physical properties appraised (R. II 61a). Since the appraisal exceeded the $13,746,000 amount of the mortgages, the corporations' boards of directors in special meetings on December 11, 1950, authorized the distribution as dividends of "the unexpended amount remaining of the proceeds of the * * * mortgage loan" (R. II 60a-61a). Accordingly dividends at the rate of $2,472.10; $1,758.67; $1,563.52; $2,193.46; $1,855.90; and $1,346.80 per share of common stock, respectively, for each of the six corporations were paid (R. II 61a). Of the $2,084,823.74 thus distributed to the common stockholders,[5] the Hutmans received about $600,000, the Gordons about $550,000, and the Prestons over $400,000 (R. II 61a-62a). Each corporation also paid to FHA dividends of 5¢ per share on each of its 100 shares of first preferred stock (or a total of $5.00) (S.D. Exs. 23a-f).

The Present Proceedings. On July 22, 1955, the Commissioner, by registered letters, requested the president of each of the corporations to call a special meeting of the first preferred stockholders for the purpose of voting on the removal of existing directors and the election of new directors as provided in Article VI of the charter, *supra*, p. 4 (R. II 67a-68a). The basis of the request was, *inter alia*, that the declaration and distribution of dividends violated Articles IV(b)

---

[5] $1,878,937.61 of the dividend distribution represented the excess of the mortgage loan over the actual costs of construction plus the 6½% I.D.S. fee (R. II 67a); the balance, $205,886.13, represented net rents of the corporations (R. II 67a).

and V(a) of the corporate charters (R. II 27a).[6] Upon the presidents' failure to comply with this request, the Commissioner, invoking Article VI(c) of the charters (R. I 122), published on August 3, 1955, notice of such meetings, to be held on August 15, 1955, in the Post Office Building, Alexandria, Virginia (R. II 39a).

Thereupon, petitioners instituted these actions in the District Court seeking to enjoin the proposed actions of the Commissioner (R. II 18a). Petitioners denied that defaults had occurred with respect to the dividend distributions and claimed, among other things, that those payments were proper under the Virginia Code, the corporate charters, and by-laws (R. II 27a). After trial, the District Court held that Articles IV(b) and V(a) of the corporate charters permitted dividend payments only out of net earnings, and hence, that the dividends paid from excess mortgage proceeds violated the charters (R. I 164-174).[7] The court accordingly dismissed the complaints (R. I 174).

---

[6] Other defaults asserted by the Commissioner were the lending of corporate funds in violation of By-law 1, Article III(d) and V(a) of the charters; and the payment of initial service charges to Investors' Diversified Services, Inc., in the amount of six and one-half percent of the mortgage loan (about $900,000), in violation of the contract of insurance and of Section III(11) and (12) of FHA Administrative Rules and Regulations (24 C.F.R. 280.19, 280.20), which limited such charges to one and one-half percent of the loan (R. II 26a-28a).

[7] The District Court stated that, in view of the basis for its upholding the proposed actions of the Commissioner, it was unnecessary to pass upon the alleged defaults of the corporations in paying the 6½% fee to I.D.S. The court stated, additionally, that this issue, which involved a complex factual determination, should be resolved in a separate action for its recovery (R. I 166). Such an action was subsequently instituted and is now pending in the United States District Court for the Eastern District of Virginia.

On appeal, the Court of Appeals affirmed (Pet. App. 1A-10A). The court observed initially that the charters prescribed by FHA were designed to give that agency "control over building corporations whose operations were to be conducted for the profit of common stockholders but at the risk of FHA, which guaranteed the payment of loans from which the real invested capital of the corporations was derived" (Pet. App. 4A). The court went on to hold that, in view of the detailed and strict limitations in the charter on the conduct of corporate financial affairs, Article IV(b) must be read as permitting the payment of dividends only out of net earnings (Pet. App. 5A).[8] The court further noted that the distribution of the money which was borrowed for the express purpose of building the apartments was a clear depletion of the assets available to pay the FHA insured loan, in violation of Article V(a) of the charters, *supra*, p. 4 (Pet. App. 7A-8A). The court rejected petitioners' claim that the legislative history revealed a congressional intent to permit the distribution of excess mortgage proceeds, and found instead that Congress had recognized such a distribution to be an abuse to be guarded against, and that the charter restrictions on distributions of corporate funds were the safeguards utilized by FHA (Pet. App. 8A-9A). The court concluded that FHA was not estopped to insist upon its rights under the charters, agreeing with the District

[8] The court also commented (Pet. App. 5A): "Where the charter provides explicitly that, in case of liquidation, the net assets shall be applied to the payment of the mortgage before anything can be paid on stock, it would be absurd to permit net assets to be siphoned off to stockholders in a partial liquidation under the guise of dividends, and particularly is this true where the net assets thus transferred to stockholders constitute mere borrowed capital for which the insured mortgage has been executed."

Court that estoppel was both factually and legally inapplicable (Pet. App. 9A-10A).

ARGUMENT

1. Article IV(b) of the corporate charters provides (R. I 116):

> The net earnings of the corporation, after providing therefrom dividends on First Preferred Stock and on the Second Preferred Stock as hereinabove provided, and all reserves hereinafter required, may be applied each year in payment of dividends to the holders of Common Stock or may be applied or used in the redemption of the Second Preferred Stock as hereinafter provided.

Petitioners argue that this Article is not restrictive but permissive only, and that the propriety of the dividend distribution is to be measured against the Virginia law and the corporate by-laws which they assert authorize such distributions.

Despite petitioners' elaborate effort to demonstrate the soundness of this position, the courts below—properly we will show—held instead that Article IV(b), as well as Article V(a),[9] prohibited the payment of dividends out of sources other than net earnings. It follows, as the Court of Appeals hold (Pet. App. 6A-7A), that, in view of the express subjection to contrary provisions of the corporate charters, the allegedly broader

---

[9] While we believe that the courts below properly held that the dividend distributions violated both Article V(a) and IV(b), our discussion in the text will be limited solely to Article IV(b). We do this because the Court of Appeals relied primarily upon Article IV(b) and to discuss Article V(a) in addition to Article IV(b) would unduly prolong this brief.

scope of Section 13-206 of the Virginia Code[10] and petitioners' By-law 42[11] (the provisions upon which petitioners rely) is immaterial here.[12]

(a) At the outset, it should be noted that petitioner corporations were not ordinary private corporations subject only to normal restraints. As the District Court pointed out, the corporations were "the focal point of

---

[10] Section 13-206 of the Virginia Code (1950) provides:

> The board of directors of every corporation shall *unless otherwise provided in its charter*, certificate of incorporation, or articles of association, or in any amendment thereto, have power to declare and pay dividends upon the shares of its capital stock out of its net earnings, or out of its net assets in excess of its capital as hereinafter defined. [Emphasis added throughout unless otherwise noted.]

[11] Petitioners' By-law 42 states (R. I 125-126):

> 42. *Subject to the provisions of the Certificate of Incorporation*, the directors may declare and pay dividends on the shares of the capital stock of the corporation out of the net earnings or out of its net assets in excess of its capital as defined by Section 3840 [now Section 13-206] of the Code of Virginia, at such times and in such amounts as the Board of Directors may from time to time designate. No dividend shall be paid in whole or in part from contributed surplus, upon any shares of stock without par value without written notice being given to stockholders receiving the same, at the time of payment of any such dividend.

In any case, it is settled that corporate by-laws cannot modify a charter and are operative only to the extent that they are consistent with the charter's terms and intent. See generally, 8 Fletcher, *Cyclopedia of Corporations*, Section 4190. Accordingly, even without the "subject to" qualification in By-Law 42, the charter would control.

[12] While the Court of Appeals regarded Section 13-206 of the Virginia Code and petitioners' By-law 42 as immaterial here, it did observe that "in the application of sound accounting principles, dividends may ordinarily be declared only out of actual earnings or profits and not upon a theoretical estimate of an unrealized appreciation in value of assets" (Pet. App. 7A). It is in connection with this obiter comment that petitioners allege a conflict with other decisions (see Pet. 48-58). The conflict, however, does not in fact exist for the cases cited by petitioners involve

the plan formulated and adopted by FHA to accomplish the congressional aim expressed in" Section 608 of the National Housing Act, *infra,* pp. 24-25 (R. I 167). Moreover, unlike ordinary commercial corporations, operating on and risking only private capital, the Federal Government assumed the principal risk of loss. The mortgagors had only a nominal investment of $1,000 in each corporation (*supra,* p. 6) and the mortgagee, in case of default, was insured against loss by the FHA. In order to protect the heavy potential liability of the Government and to forestall the possibility of financial manipulation by prospective sponsors of these projects, the FHA promulgated a series of regulations setting up standards, procedures, and restrictions designed, among other things, to protect the Government's potential liability on the mortgage. 24 C.F.R. (1949 ed.) 280.1-280.41. Included among these was a requirement that in all cases where the insured mortgage is in excess of $200,000 the mortgagor must be a corporation or trust created with the Commissioner's approval, and regulated by him to such an extent as he deems advisable until the mortgage insurance obligations terminate. 24 C.F.R. (1949 ed.) 280.26. The regulations further provided that the mortgagor was to be regulated through ownership by the Commissioner of shares of a special stock which would acquire majority voting rights in the event of a default in the mortgage or violation of a charter

---

not the Virginia statute but rather the laws of other states, particularly New York. Moreover, there can be no doubt that the New York view represents a distinct minority. See *Commissioner of Internal Revenue* v. *Hirshon Trust Co.*, 213 F. 2d 523, 527 (C.A. 2), certiorari denied, 348 U.S. 861 (opinion by Judge, now Mr. Justice, Harlan); Dodd and Baker, *Cases and Materials on Corporations* (1951) at p. 1086; see also cases cited at Pet. App. 7A.

provision. 24 C.F.R. (1949 ed.) 280.29. Pursuant to the regulations, prospective mortgagors, such as petitioners, were required by the FHA to utilize as their corporate charter, the model prescribed by the agency. 24 C.F.R. (1949 ed.) 280.26.

The charter imposed on petitioner corporations by the FHA under Section 608 is composed almost exclusively of a long list of restrictions limiting the operational and fiscal actions of the corporations. Virtually every aspect of corporate activity is sharply circumscribed to the end, among other things, of protecting the Government's heavy potential financial stake (R. I 115-124). Since the purpose of the charter as a whole is restrictive, it is reasonable to conclude, as did the Court of Appeals, that the dividend provision was also of that category. This is particularly so since the charter restrictions are patently designed to protect the security, both monetary and property-wise, underlying governmental liability and to safeguard against financial buccaneering. Alienation or dilution of that security may readily be accomplished through the dividend device, thereby lessening the financial responsibility of the corporations. The most feasible safeguard in that respect is a restriction of the source of dividend payments to the net earnings of the corporations.[13]

---

[13] Petitioners' effort to read their charters as not imposing a dividend restriction because of the lack of such a restriction in FHA's Regulatory Agreements with individual builders (Pet. 36-38) ignores the crucial difference between the two situations. Since FHA regulations permit construction by individuals only when the mortgage is under $200,000 (see 24 C.F.R. (1949 ed.) 280.26c), cost estimates can be more accurate, there is no substantial opportunity for large scale manipulation, and, most important, the builders are subject to a personal unlimited liability for any defi-

(b) Other factors reinforce the holdings below that Article IV(b) was designed to restrict the dividend source. The criteria under which dividend payments may be made vary from state to state. See Kehl, *Corporate Dividends,* pp. 28-81. Consequently, if petitioner's reading of Article IV(b) were accepted, dividend distributions would be subject to the disparate standards set up by the various state corporation laws—certain of which standards, as is evident from petitioners' own arguments (Pet. 48-58), would plainly not provide adequate protection for a highly vulnerable guarantor such as the FHA.

Moreover, the statement of a sole specific source of dividends by Article IV(b) indicates the exclusion of other sources. In fact, if this were not its intent, the inclusion of Article IV(b) in these charters, with its singling out "net earnings," would be pointless. The laws of the state of incorporation either permit dividend payments from net earnings or they do not. If they permit payments from that source, the charter provision, construed as permissive only, is without significance. If state law forbids payment from net earnings, the charter provision would be a legal nullity. On the other hand, if state law permits dividend declarations from net earnings and from other sources as well, which is the case in some states, perhaps including Virginia, Article IV(b) serves to restrict the source of dividends for Section 608 corporations. Only by reading Article IV(b) as a uniform national restric-

---

ciency. In contrast, a corporation has only limited liability which would be further reduced by dividends of the nature involved in this case, and in many Section 608 corporations, as here, the common stockholders' cash investment was at most nominal.

tion, applicable to all Section 608 corporations, is there any justification for its inclusion in the charters.[14]

Nor would it be appropriate to read Article IV(b) as a limited restriction, *i.e.*, as barring dividend payments to holders of the common stock until after dividends are paid on the preferred stock and reserves are set aside. Such restrictions are expressly set forth in other parts of the same Article. Article IV(a) provides that the preferred holders will receive their dividend before any distribution is made to holders of the common, and Article IV(d) provides that no dividends shall be paid until amortization payments have been made, and until the reserve fund for replacement has been established and maintained (R. I 116-119). Accordingly, if Article IV(b) is to be accorded any significance, it must be interpreted as a complete limitation on the source of dividends.

(c) Further corroboration that Article IV(b) was intended to restrict dividend payments to net earnings is found in the Uniform System of Accounts promulgated by the FHA for use by all Section 608 corporations, including petitioner corporations (Def. Ex. 6,

---

[14] Petitioners' reliance on *Weinberg* v. *Baltimore Brick Co.* (Del. 1955), 114 A. 2d 812, as a case involving "[p]ermissive language similar to that contained in IV(b)" (Pet. 44) is misplaced. The only question involved in that case was whether a charter provision allowing payment of dividends out of "net earnings" permitted dividends from current earnings even though the corporation did not have an overall surplus of assets over capital. The Delaware court said that it did. Significantly, in analyzing the phrase "net earnings" the court stated that it would give the phrase "the meaning that appears most reasonably adapted to the context in which it is used" (114 A. 2d at pp. 816-817) and that such meaning was supported by the corporate history of the company (114 A. 2d at p. 818). These factors hardly advance petitioners' position.

R. I 124). Nowhere in this Uniform System is there any provision for the creation of a speculative book surplus based on alleged but unrealized appreciation of fixed assets above cost—petitioners' asserted justification for distributing the excess mortgage proceeds in these cases. In fact, the system prescribed by the FHA precluded such manipulation. Thus, land, buildings, and all other fixed assets were to be carried at cost (R. II 69a-70a),[15] a requirement which in itself bars the use of appraisal figures to create surpluses for the purposes of declaring dividends.

More significantly, contrary to petitioners' assertion (Pet. 85), the Uniform System does not provide for payment of dividends out of capital surplus. Instead, the Uniform System expressly provides (1) for the crediting of the Earned Surplus Account with profits from the Profit and Loss Account, the account which reflects current earnings; and (2) for debiting the Earned Surplus Account with the declaration of dividends.[16] It is thus plain that the Uniform System of

---

[15] The Uniform System of Accounts provides:

1410 *Land.*—The purchase price of land plus the cost of improvements to the land will be charged to this account.

1420 *Buildings.*—The total cost of the buildings, exclusive of equipment, furniture and furnishings, will be charged to this account.

[16] The Uniform System of Accounts further provides:

2140. *Dividends Payable.*—When the Board of Directors of the Corporation declares a dividend, a journal entry should be made charging Surplus and crediting the Dividends Payable account. When the dividend is paid this account will be debited and a corresponding credit will be made to the account necessary to record the means of payment. Any balance in the account will represent dividends which have been declared but have not been paid.

3210. *Earned Surplus.* Credits to the Earned Surplus account will come from journal entries transferring a profit

Accounts contemplates the payment of dividends only out of net earnings.

2. As further supporting the propriety of their dividend distributions, petitioners undertake, again in elaborate detail, to show that Congress was cognizant of, if indeed it did not sanction, the "mortgaging out" [17] practices which led to windfalls, such as petitioners', under the Section 608 program. This congressional purpose, petitioners assert, is demonstrated by the legislative history of Section 608 itself, and by a comparison of Section 608 with other enactments, specifically Sections 207 and 908, also dealing with FHA mortgage insurance of apartment developments. Examination of these materials, however, shows the contrary, and that in fact Congress intended that all steps possible be taken to eliminate possible abuses under the program.

(a) While Congress believed that the success of the Section 608 program required the making of insurance commitments in advance of construction on the basis of estimated costs (see S. Rep. No. 772, 80th Cong., 1st Sess.), it directed from the program's inception in 1946 that the insurance commitments be pegged to "*necessary* current cost." See R. I 3-5. Subsequently, legislative action was taken to reinforce that standard. Thus, in 1947, when Congress became aware that in some cases excessive cost estimates had resulted in

---

from the Profit and Loss account, adjusting prior earnings for income not recorded during the period in which it was earned and adjustments in surplus reserves. Debits will arise from transferring a loss from Profit and Loss, *the declaration of dividends,* adjusting prior earnings for expenses not recorded during a prior period to which they apply and allocations of surplus to reserves.

[17] The term applied to a case where the amount of the insured mortgage equalled or exceeded the actual cost of the project.

FHA insurance commitments exceeding 90% of actual costs, it enacted an amendment to Title VI declaring that (61 Stat. 945):

> Title VI of the National Housing Act, as amended, shall be employed to assist in maintaining a high volume of new residential construction *without supporting unnecessary or artificial costs. In estimating necessary current cost for the purposes of said title, the Federal Housing Commissioner shall therefore use every feasible means to assure that such estimates will approximate as closely as possible the actual costs of efficient building operations.*

The following year, 1947, Congress sought further to eliminate possible windfalls by adding in Section 608 a further safeguard to the effect that (62 Stat. 1269):

> * * * the principal obligation of the mortgage shall not in any event exceed 90 per centum of the Administrator's estimate of the replacement cost of the property or project on the basis of the costs prevailing on December 31, 1947, for properties or projects of comparable quality in the locality where such property or project is to be located * * *.

Such express legislative action belies the claim that Congress intended to sanction windfall profits for the builders. See also, *infra,* fn. 19, p. 21.

Similarly, the FHA representatives consistently advised Congress that they were taking all possible steps, in their administration of the Section 608 program, to minimize abuses. Thus in the hearings on the Housing Act of 1949, FHA officials stated to the Senate Commit-

tee on Banking and Currency that it was FHA policy to prevent "mortgaging out" abuses, and reassured the Committee that devices were being applied to prevent that occurrence (R. I 32-34). It was further stated that while FHA estimates might be off two or three or even five percent, it was hardly possible for them to be off much more than that. (See R. I 51-52, 61-62, 75-76.) The Assistant Administrator charged with administration of the Section 608 program testified that windfalls resulting from grossly excessive cost estimates were unknown to him (R. I 55-56).

Not only did FHA seek to prevent abuses, but, of particular significance here, it advised Congress that should the estimated costs exceed actual costs, the excess would have to be retained in the corporate treasury. Thus the Housing and Home Finance Administrator stated (R. I 34):

> * * * as I indicated, devices are applied to attempt to prevent what you have in mind, namely, that a man will come out with a profit out of the mortgage.
>
> Senator LONG. We do not want that to happen?
>
> Mr. FOLEY. We do not. At the most, or at the best, from his point of view he should come out with his profit still tied up, using the word profit in a rather broad sense. * * *

It is a distressing fact, as brought out in the 1954 hearings and report of the Capehart Committee in its investigation of the FHA, that certain officials of that agency grossly abused their positions of trust, resulting, among other things, in the approval of inflated cost estimates. See Hearings before the Senate Committee

on Banking and Currency, pursuant to S. Res. 229, 83rd Cong., 2d Sess. That Congress did not intend that the Section 608 housing program would be the instrument for distributing millions of dollars in windfall profits is borne out by the reaction to this scandal. Cost certifications were immediately required, and FHA officials who knowingly or unwittingly countenanced these abuses were discharged.

(b) Nor does petitioners' attempt to contrast the Section 608 program with the Section 207 program further their position. For while a FHA brochure promoting the Section 608 program stated that corporate mortgagors under that Section are not limited as to "dividends or rate of return", as is the case under Section 207 (Pet. 84), this does not help petitioners. Under the Section 207 program, dividends were limited to approximately six percent annually (R. I 96), whereas, under the Section 608 program, dividends were limited only by the amount of net earnings of the corporations which may well exceed the six percent limitation of Section 207. This, however, has no bearing on the sources from which the dividends may be paid. Under the Section 608 program, the source of the dividends, as contrasted to the rate, is limited by the charter to net earnings. So long as dividends are paid out of net earnings and the amount declared is within the net earnings there is no limitation on the rate which may be paid.[18]

(c) Equally unavailing is petitioners' attempt to compare Section 608 with the provision in the sub-

---

[18] In the Hearings on the 1949 Housing Act, FHA pointed out that the return on a Section 608 development could range up to 17%. See Hearings before a Subcommittee of the Senate Committee on Banking & Currency on S. 2246, 81st Cong., 1st Sess., p. 458.

sequently enacted Section 908 program requiring the mortgagor, after the completion of construction, to certify the amount by which the mortgage loan exceeds actual cost and to apply this amount against the mortgage loan. See R. I 7. Although the Section 608 program did not require such immediate repayment of the excess, the absence of such a requirement does not negate an intent that the excess remain a part of the corporate assets securing the Government-insured loan. While, as the court below pointed out, petitioners might properly have applied the excess to repayment of the mortgage, although not required to do so under their charters, "[t]he insured loans have many years to run, years in which no one can foresee the course of prices and values. The possession by the mortgagor corporations of these assets will add to the protection of the risk assumed by FHA * * *" (Pet. App. 9A).[19]

3. Petitioners finally argue that doctrines of estoppel or "contemporaneous construction" preclude the FHA from exercising its charter rights in protection of the Government's interest. But the materials on which petitioners rely to show "contemporaneous construction" are in large measure the same materials advanced by petitioners in support of their position on the merits,

---

[19] The certification and repayment provision enacted in Section 908 was suggested for the first time by a witness at the hearings in 1951. See Hearings before the Senate Committee on Banking & Currency on S. 349, 82d Cong., 1st Sess., p. 153. Subsequently, Senator Schoeppel questioned an industry witness about the abuses under the old Section 608 program and inquired about the proposed safeguard. *Ibid.* at p. 516-517. Immediately following is the very revealing comment of Senator Bricker (*ibid.* at p. 518):

> The chairman will remember 4 years ago [*i.e.*, 1947, see *supra*, p. 18] we tried to write a provision into the bill to protect against this thing Senator Schoeppel brought up. It is rather difficult to do. We worked on it for weeks there.

and as we have already shown in that connection, the materials do not bear out petitioners' claim. As to estoppel, it is, of course, inapplicable as a legal matter, notwithstanding petitioners' contention that FHA was acting "in its proprietary and contractual capacity" (Pet. 83). *Federal Crop Insurance Corp.* v. *Merrill,* 332 U.S. 380; *Utah Power and Light Co.* v. *United States,* 243 U.S. 389, 409; *United States* v. *Summerlin,* 310 U.S. 414; *Sherman* v. *United States,* 155 U.S. 673, 685.

Moreover, there is no estoppel as a factual matter. Petitioners contend that since its annual financial statements transmitted to the FHA revealed the dividend declaration and the Commissioner accepted its "share of the dividends" (Pet. 86), FHA is now estopped to attack the dividends paid to the common stockholders. It is difficult, however, to see how the receipt of a 5¢ dividend on the preferred stock would estop FHA from claiming that the vastly disproportionate dividend (ranging to well over $2,000) paid on the common stock (for which only $5 was paid) violated the corporate charters. In any case, the District Court expressly found (R. I 173):

> * * * A preponderance of the evidence does not prove that he [the Commissioner] was then acting with full knowledge of the source of the dividend. If a dividend had been declared, he was required to collect the amount due on the preferred stock. In doing so he cannot be presumed to have upheld the legality of the [dividend] distribution.

This finding was upheld by the Court of Appeals (Pet. App. 9A-10A), and, under the two-court rule, is conclu-

sive at this stage. *Comstock* v. *Group of Investors,* 335 U.S. 211, 214; *United States* v. *Dickinson,* 331 U.S. 745, 751; *Allen* v. *Trust Co.,* 326 U.S. 630, 636; *Pick Mfg. Co.* v. *General Motors Corp.,* 299 U.S. 3, 4.

CONCLUSION

The judgment below is correct and there is no conflict of decisions. Accordingly, it is respectfully submitted that the petition for a writ of certiorari should be denied.

J. LEE RANKIN,
Solicitor General.

GEORGE COCHRAN DOUB,
Assistant Attorney General.

MELVIN RICHTER,
MARCUS A. ROWDEN,
Attorneys.

APRIL, 1957.

APPENDIX

Section 608 of the National Housing Act, 56 Stat. 303, as amended, 12 U.S.C. 1743, in effect at the time here involved, provided in pertinent part:

> (a) In addition to mortgages insured under section 1738 of this title, the Commissioner is authorized to insure mortgages as defined in section 1736 of this title (including advances on such mortgages during construction) which are eligible for insurance as hereinafter provided.
>
> (b) To be eligible for insurance under this section a mortgage shall meet the followng conditions:
>
> (1) The mortgaged property shall be held by a mortgagor to be approved by the Commissioner. The Commissioner may, in his discretion, require such mortgagor to be regulated or restricted as to rents or sales, charges, capital structure, rate of return and methods of operations. The Commissioner may make such contracts with, and acquire for not to exceed $100 stock or interest in any such mortgagor, as the Commissioner may deem necessary to render effective such restriction or regulation. Such stock or interest shall be paid for out of the War Housing Insurance Fund, and shall be redeemed by the mortgagor at par upon the termination of all obligations of the Commissioner under the insurance.
>
> (2) Preference or priority of opportunity in the occupancy of the mortgaged property for veterans of World War II and their immediate families, and for hardship cases as defined by the Commissioner, shall be provided under such regulations and procedures as may be prescribed by the Commissioner.
>
> (3) * * *
>
> * * * * *

(B) not to exceed 90 per centum of the amount which the Commissioner estimates will be the necessary current cost of the completed property or project, including the land; the proposed physical improvements; utilities within the boundaries of the property or project; architects' fees; taxes and interest accruing during construction; and other miscellaneous charges incidental to construction and approved by the Commissioner: *Provided,* That such mortgage shall not in any event exceed the amount which the Commissioner estimates will be the cost of the completed physical improvements on the property or project, exclusive of off-site public utilities and streets, and organization and legal expenses: *And provided further,* That the principal obligation of the mortgage shall not, in any event, exceed 90 per centum of the Commissioner's estimate of the replacement cost of the property or project on the basis of the costs prevailing on December 31, 1947, for properties or projects of comparable quality in the locality where such property or project is to be located; and

(C) not to exceed $8,100 per family unit for such part of such property or project as may be attributable to dwelling use.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1947 430099 1147